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Financial Condition EXAMINERS HANDBOOK

2019

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Handbook 2019 Edition

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PREAMBLE

The primary purpose of a risk-focused examination is to review and evaluate an insurer's business processes and controls (including the quality and reliability of corporate governance) to assist in assessing and monitoring its current financial condition and prospective solvency. As part of this process, the examiner identifies and evaluates risks that could cause an insurer's surplus to be materially misstated both currently and prospectively. In order to complete this task efficiently and effectively, examinations should be planned to identify and focus on areas of higher risk. The guidelines contained within this Handbook have been designed to assist examiners in conducting financial condition examinations in a manner consistent with the primary purpose. Although extensive guidance is provided, examiners are still asked to exercise judgment and professional skepticism throughout the process in order to support an effective and efficient solvency oversight framework.

The risk-focused surveillance framework is designed to provide continuous regulatory oversight, which includes both the financial analysis function and the financial examination function. Coordination between the two functions is, therefore, vital to ensure appropriate oversight is maintained in an effective and efficient manner. The analyst is responsible for the continuous monitoring of the company and should, therefore, provide insight at the beginning of an examination into different trends or possible risk areas that the analyst has identified through regular monitoring based on reporting by the company. The examiner is then responsible for going on-site to the company to review the risks in more detail and learn about the effectiveness of the company's controls and processes. At the conclusion of the examination, the examiner should have gained enough knowledge to pass along valuable insight and, at times, recommendations for follow-up to the analyst to assist in the ongoing monitoring of the company. The two functions, while separate, share a common goal that requires coordination and communication to ensure that the future obligations to policyholders can be met.

In conducting an examination, a full understanding of the insurer must be obtained by discussing relevant issues with the analyst; reviewing relevant documents, including the Insurer Profile Summary (IPS); and conducting C-level interviews, etc. In addition, an understanding and assessment of the insurer's corporate governance and risk management environment enhances the examiner's overall understanding of the company. It is important to recognize that variations in the practices of each individual insurer are expected, in accordance with the nature and extent of their operations, but the quality of guidance and oversight provided by the board of directors, as well as the effectiveness of management, will enhance the examiner's ability to identify and evaluate risks. Upon gaining an understanding of the company, including corporate governance, the examiner must then exercise judgment to identify and assess the most significant solvency risks facing the company, both current and prospective, that will require examination resources to perform further investigation.

Once the most significant risks are identified, the examiner will use a combination of controls/risk-mitigation strategies and/or detail test procedures to address each risk and determine if the risk is adequately mitigated. The review and testing of internal controls/risk mitigation strategies is crucial to assessing the insurer's ability to continue producing accurate financial information and mitigating other-than-financial reporting risks in the years between examinations. Additional detail tests are performed, as necessary, to address residual risks that remain after comparing the assessed level of inherent risk identified to the strength of internal control/risk-mitigation strategies in place to address the risk. When performing control or detail testing, the examiner is encouraged to utilize existing work, when possible, to increase efficiency. Sources that may provide work that can be leveraged include internal/external auditors, as well as reports required in order to comply with the federal Sarbanes-Oxley Act of 2002 (SOX); the NAIC *Annual Financial Reporting Model Regulation* (#205), which is commonly referred to as the Model Audit Rule (MAR); and the Own Risk and Solvency Assessment (ORSA) reporting requirement. After completing control and detail testing, as necessary, current or prospective risks that are not fully mitigated should be communicated to the financial analyst or others within the insurance department responsible for solvency monitoring. Depending on the nature of the risk or finding, issues may also need to be reported to company management or the board of directors, as determined by the examination team.

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INTRODUCTION

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INTRODUCTION

This Handbook is a guide to assist state insurance departments in conducting risk-focused examinations, as a key component of establishing and operating an effective risk-focused surveillance process. The purposes of a risk-focused surveillance process are (1) to detect as early as possible those insurers with potential financial trouble; (2) to timely identify noncompliance with state statutes and regulations; (3) to compile the information needed for timely, appropriate regulatory action; (4) to provide a clearer methodology for assessing residual risk in each activity under review and to explain how that assessment translates into establishing examination procedures; (5) to allow the assessment of risk management processes in addition to those that result in financial statement line item verifications, for example, the effectiveness of the board of directors and other corporate governance activities, thus providing an introspective look at the operations and quality of the risk management processes of the insurer; and (6) to allow for the utilization of examination findings to establish, verify or revise the company's priority score determined through the department's analysis and utilization of the NAIC tools (e.g., Scoring System, IRIS ratios). These elements allow for examinations that emphasize the analysis of an insurer's current or prospective solvency risk areas as well as the fair presentation of surplus. To conduct an effective risk-focused examination, examiners must have adequate training and experience and appropriately involve key regulatory functions in the department, to assist in exercising sound judgment at every stage of the examination process. Enhanced risk assessment is not intended to add additional hours to the examination process, but to assist the examination teams in better allocating their hours to the most critical risks facing the companies they regulate.

The concepts presented in this Handbook can be applied to all examinations; however, modifications may be warranted based upon the nature and size of specific entities. Risk-focused examinations allow flexibility for procedures to be added, modified, supplemented or reduced, in accordance with the overall risk assessment of the insurer. The NAIC acknowledges that considerable judgment will be required of the examiner in completing risk assessments.

A. History of Risk Assessment and Process of Conducting Examinations

In 2004, the NAIC Risk Assessment Working Group adopted the Risk-Focused Surveillance Framework, whose principles set the foundation for the enhancement of the risk assessment components of this Handbook. Although editions of the Handbook prior to 2007 already utilized a risk-focused approach, that approach focused only on financial reporting issues and audit risk. A broader, organization-wide business risk assessment including strategic and operational issues enhances the process for evaluating the entire solvency risks inherent in an insurer's operations. The enhancement in the risk assessment process and supporting tools will also improve the ongoing surveillance of the insurer. The risk-focused surveillance process includes a formal system for identifying risk, processes for assessing and documenting that risk, and recommendations for how the assessment can be applied in the examination process and to the ongoing monitoring of the insurer.

The revised risk-focused surveillance process was developed by the NAIC in response to a recommendation by the Risk Assessment Working Group. The recommendation was based on the need to enhance the qualitative aspects of examination and financial analysis functions. These enhancements will allow the financial solvency surveillance process to better incorporate prospective risk assessment in identifying insurers that have or will encounter solvency issues and bring focus to the broader issue of the ability of management to identify, assess and manage the business risks of the insurer. These enhancements are considered to be directly aligned with the NAIC Solvency Initiatives.

Historically, many solvency problems have been caused by inadequate management oversight. Inadequate management oversight typically results in inaccurate financial reporting which can prevent the regulator from taking timely remedial or regulatory actions and thus reduces the options available for corrective steps. Solvency issues generally result from business risks that were not mitigated to an acceptable level by company controls. Inadequately controlled operating risks may take several years to be reflected in the company's financial statements.

The Risk Assessment Working Group has determined solvency surveillance needs a broader risk focus to become more proactive in identifying emerging solvency issues. As the revised approach is implemented by state insurance departments, examination activities will be enhanced by a risk-focused methodology that:

- More clearly directs financial statement verification to only those key accounts and control objectives of those

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accounts with the greatest risk, and

- Directs the examination focus to the identification of significant strategic and operating risks, investigation of mitigation strategies for those risks, and recommendations for enhancements where appropriate to reduce residual risks to a more acceptable level.

B. Overview of Risk-Focused Surveillance Process

The intent of the risk-focused surveillance process is to broaden and enhance the identification of risk inherent in an insurer's operations and utilize that evaluation in formulating the ongoing surveillance of the insurer. This assessment could be completed on a legal entity basis or on an organization-wide basis depending on how the company structures its business. Through their activities, insurers assume a variety of risks, which is the essence of an insurance transaction. The type of risk and its significance varies by activity. Investment activities may involve credit risk, market risk and liquidity risk. In product sales, insurers may assume market risk, pricing/underwriting risk, strategic risk or liquidity risk in varying degrees, depending on the product. Over the years, state insurance regulators have developed numerous tools to address the risks insurers assume. Investment laws limit the market and credit risk insurers can assume. Limitations on net retentions help reduce catastrophe risk. Risk-based capital requirements establish capital levels in recognition of a variety of risks. Insurance regulators have always considered the risk profiles of licensed insurers and the activities that may pose risk to the company in the future. The risk-focused surveillance process utilizes an organization-wide risk assessment process to enhance evaluation and to better coordinate the activities of financial solvency surveillance through greater consistency within the department, and with other departments.

A risk-focused surveillance process includes identifying significant risks, assessing and analyzing those risks, documenting the results of the analysis, and developing recommendations for how the analysis can be applied to the ongoing monitoring of the insurer. This increased attention by regulators to risk assessment and risk management processes utilized by insurers will be a positive development.

The enhancements included in the risk-focused surveillance process intend to provide the following benefits:

1. Strengthen regulatory understanding of the insurer's corporate governance function by documenting the composition of the insurer's board of directors and the executive management team as well as the quality of guidance and oversight provided by the board and management.

2. Enhance evaluation of risks through assessment of inherent risks and risk management processes regarding weaknesses of management's ability to identify, assess and manage risk.

3. Improve early identification of emerging risks at individual insurers on a sector-wide basis.

4. Enhance effective use of regulatory resources through increased focus on higher risk areas.

5. Increase regulatory understanding of the insurer's quality of management, the characteristics of the insurer's business and the risks it assumes.

6. Enhance the value of surveillance work and establishment of risk assessment benchmarks performed by insurers and regulators, who have common interest in ensuring that risks are properly identified and that adequate, effective control systems are established to monitor and control risks.

7. [illegible] and document the risk assessment process via the use of the risk assessment matrix tool to assist in examination planning and resource assignment.

8. Expand risk assessment to provide a more comprehensive and prospective look at an insurer's risks through identification of the insurer's current and/or prospective high-risk areas.

9. Coordinate the results of the risk-focused examination process with other financial solvency surveillance functions

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(i.e., establishing/updating the priority score and supervisory plan).

In full, the risk-focused surveillance process provides effective procedures to monitor and assess the solvency of insurers on a continuing basis. The risk-focused surveillance process is embedded in the planning activities and throughout each phase of the risk-focused surveillance process discussed in detail within this Handbook. The revised approach consists of a structured methodology designed to establish a forward-looking view of an insurer's risk profile and the quality of its risk management practices. This approach permits a direct and specific focus on the areas of greatest risk to an insurer. Through this approach, state insurance regulators can be more proactive and better positioned to identify and respond to any serious threat to the stability of the insurance company from any current or emerging risks. This regulatory approach will benefit all participants in the insurance marketplace.

C. Risk-Focused Surveillance Cycle

The system of financial surveillance advocated by the Risk-Focused Surveillance Framework is designed to provide continuous regulatory oversight. The risk-focused approach requires fully coordinated efforts between the financial examination function and the financial analysis function. There should be a continuous exchange of information between the field examination function and the financial analysis function to ensure that all members of the department are properly informed of solvency issues related to the state's domestic insurers.

Responsibilities of the analysts in the Risk-Focused Financial Surveillance Framework are (1) to monitor the states' domestic insurers; (2) to provide updates to the Insurer's Profile Summary; (3) to provide input for the department's priority score for each insurer; and (4) to provide department management with timely knowledge of significant events relating to the domestic insurers. This information is used by the field examination function as input for scheduling and staffing of examinations. In anticipation of a field examination, the examiners and analysts should conduct a planning meeting to facilitate the exchange of relevant information between the analyst and the examination team. As the examiners conduct the financial examinations, they should inform the analyst of any significant examination findings. At the conclusion of the on-site examination, the examiners and analysts should work together to determine the company's priority score. The development of the management letter to the company should include contributions from the examiners and analysts. It is strongly recommended that the analyst be responsible for evaluating and following-up with the company responses to the management letter comments as after the report of the examination has been issued, the analyst will be the primary regulatory contact with the company until the next examination.

The regulatory Risk-Focused Surveillance Cycle involves five functions, most of which are performed under the current financial solvency oversight role. The enhancements coordinate all of these functions in a more integrated manner that should be consistently applied by state regulators. The five functions of the risk assessment process are illustrated within the Risk-Focused Surveillance Cycle.

As illustrated in the Risk-Focused Surveillance Cycle diagram, elements from the five identified functions contribute to the development of an Insurer Profile Summary. Each state will maintain an Insurer Profile Summary for their domestic companies. Regulators that wish to review an Insurer Profile Summary for a non-domestic company will be able to request the Insurer Profile Summary from the domestic or lead state. The documentation contained in the Insurer Profile Summary is considered proprietary, confidential information that is not intended to be distributed to individuals other than state regulators.

Please note that once the Risk-Focused Surveillance Cycle has begun, any of the inputs to the Insurer Profile Summary can be changed at any time to reflect the changing environment of an insurer's operation and financial condition.

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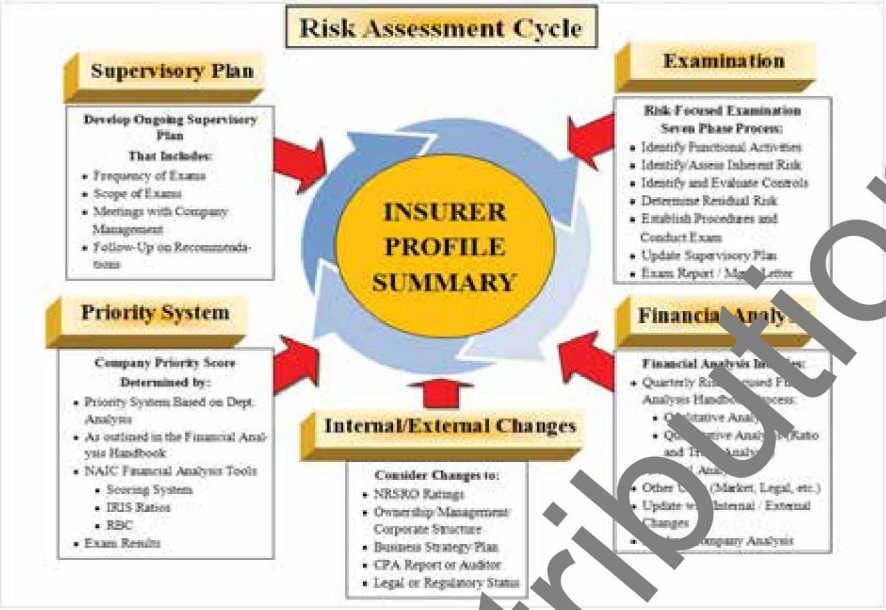

The five elements of the Risk-Focused Surveillance Cycle include: (1) risk-focused examination, (2) financial analysis, (3) review of internal/external changes, (4) priority system, and (5) supervisory plan. These elements are currently performed under state insurance regulator's current financial solvency oversight role. The enhancements integrate these functions together in a more cohesive manner, which can be consistently applied by state regulators.

Insurer Profile Summary: This profile is used to "house" summaries of risk-focused examinations, financial analyses, internal/external changes, priority scores, supervisory plans, and other standard information. This profile is intended to be a "living document" and preferably shared with other regulators who have signed the *Information Sharing and Confidentiality Agreement* verifying that such shared information would remain confidential.

Risk-Focused Examinations: These examinations consist of a seven-phase process that can be used to identify and assess risk, assess the adequacy and effectiveness of strategies/controls used to mitigate risk and assist in determining the extent and nature of procedures and testing to be utilized in order to complete the review of that activity. The process should generally include a determination of the quality and reliability of the corporate governance structure and risk management programs. In addition, it can be used for verification of specific portions of the financial statements or other limited-scope reviews, including reviews of specific operations of an insurer. The risk assessment process should result in increased focus on, and can result in increased detail testing of, accounts identified as being at high risk of misstatement. Conversely, the risk assessment process should result in decreased focus on, and fewer detail tests (if any) on the accounts identified as being at low risk of misstatement. The risk-focused surveillance process can be used to assist examiners in targeting areas of high-risk.

Financial Analysis: This function consists of processes being performed by regulators as outlined in the *Financial Analysis Handbook*. This analysis would be enhanced by stronger emphasis on the earnings performance and trends in profitability of core insurance businesses, using the residual risk determinations of the activities reviewed and examined in order to assist in determining the areas of operations that should be targeted for heightened review, and determination of the insurer's priority score and supervisory plan.

Internal/External Changes: Changes in rating agency ratings, ownership/management/corporate structure, financial condition/risk profile, business strategy or plan, external audit reports and legal or regulatory status should be considered in developing the examination priority and supervisory plan.

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Priority Score: Each domiciliary state should establish a prioritization system for examinations of their insurers. This system should utilize the department's experience and knowledge of the insurer as well as available financial analysis tools. Prioritization tools available through the NAIC include Scoring System and IRIS ratios.

As any single prioritization system does not represent a complete prioritization tool, analysts are encouraged to utilize various NAIC or internal tools and complete additional subjective analyses to establish the company's prioritization. Factors such as risk assessment results, internal/external changes and the risk appetite and effectiveness of management should be taken into consideration by the examiner and analyst to determine the overall priority score.

Supervisory Plan: At least once a year a supervisory plan should be developed or updated by the domestic state for each domestic insurer. The supervisory plan should be concise and outline the type of surveillance planned, the resources dedicated to the oversight and the consideration and communication and/or coordination with other states.

D. Purpose of Risk-Focused Examinations

The intent of the risk-focused surveillance process in a risk-focused examination is to determine areas of higher risk to enable more efficient use of examiner resources. The primary purpose of a risk-focused examination is to review and evaluate an insurer's business processes and controls (including the quality and reliability of corporate governance) to assist in assessing and monitoring its current financial condition and prospective solvency. As part of this process, the examiner identifies and evaluates risks that could cause an insurer's surplus to be materially misstated, both currently and prospectively.

With these goals in mind, the risk-focused examination approach contains seven phases: (1) understanding the company and identifying key functional activities to be reviewed; (2) identifying and assessing inherent risk in activities; (3) identifying and evaluating risk-mitigation strategies/controls; (4) determining residual risk; (5) establishing/conducting examination procedures; (6) updating prioritization and supervisory plan; and (7) drafting the examination report and management letter based on findings. The Risk Assessment Matrix is introduced as a tool that should be utilized to document the risk assessment planning progress, impressions and results. The regulator may also consider preparing a risk assessment narrative to summarize and detail the findings of the risk assessment.

The information needed to conduct the risk assessment may already exist in one form or another. More and more companies have systems in place to identify, assess and manage risks and controls. Public companies are required to have processes in place to establish and evaluate financial reporting controls in order to comply with the federal Sarbanes-Oxley Act of 2002 (SOX). SOX has five distinct objectives: (1) strengthen and restore confidence in the accounting profession; (2) strengthen federal securities laws; (3) improve executive responsibility and tone set by top management; (4) improve disclosure and financial reporting; and (5) improve the performance of audit committees, research analysts, attorneys, rating agencies and audit committee financial experts. SOX requires management to report on the establishment and effectiveness of internal controls over financial reporting. Additionally, outside auditors are required to issue an attestation on management's assertion of the adequacy of their financial reporting controls. In addition to SOX requirements, modifications to the NAIC *Annual Financial Reporting Model Regulation* (#205)—also known as the Model Audit Rule (MAR)—that went into effect for the year ending Dec. 31, 2010, require all insurance companies exceeding an annual premium threshold to issue a management's report on the effectiveness of internal controls over financial reporting. This MAR report is required to be supported by diligent inquiry, including documentation and testing of significant financial reporting controls. In addition to functions put in place to meet SOX and MAR requirements, other companies may have enterprise risk management (ERM) functions and/or an internal audit functions that conduct formal risk identification and control assessments. Large companies subject to the Own Risk and Solvency Assessment (ORSA), as defined by the NAIC *Risk Management and Own Risk and Solvency Assessment Model Act* (#505), must submit an annual ORSA report that contains extensive information regarding the company's risk-management function. Any of these resources can facilitate the risk assessment and reduce regulators' resources needed to complete the process.

E. Risk-Focused Examination Process

The concept of risk considered in examinations had historically focused on the static risk of a material misstatement of the financial condition of the company at a given point in time. The concept of risk considered in a risk-focused examination

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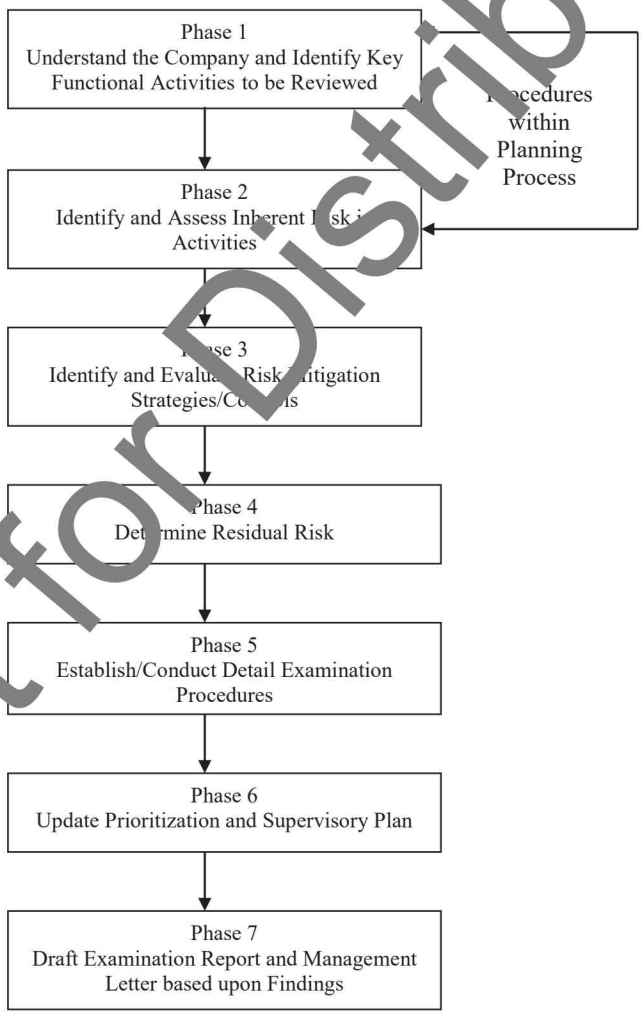
encompasses not only risk as of the examination date, but risks which extend or commence during the time which the examination was conducted, and risks which are anticipated to arise or extend past the point of completion of the examination. As such, risks in addition to the financial reporting risks may be reviewed as part of the examination process. The timing of the risk assessment during the examination has also changed as a result of the adoption of the risk-focused examination. Risk assessment has historically occurred as part of the planning process. The risk-focused examination anticipates that risk assessment may extend through all seven phases of the examination discussed below as well as link to the work carried forward by the financial analysis function.

The following chart and Handbook sections discuss the seven phases necessary to conduct a risk-focused examination. The methodology emphasizes a "risk-focused" approach whereby resulting examination fieldwork will analyze an insurer's solvency risk areas in addition to the risks associated with the fair presentation of surplus. The examiner-in-charge should use the risk assessment matrix (or similar document) as a tool to document the allocation of exam resources (by the identification of key functional activities and sub-activities) to be assessed. The approach used will be influenced by the size, complexity and effectiveness of the overall insurer's risk control environment. A flowchart of the seven phases of a risk-focused examination follows and is described in detail later in this Handbook.

See Exhibit K for the Risk Assessment Matrix tool and the linkage to the seven phases.



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Phase 1: Understand the company and identify key functional activities to be reviewed: In Phase 1, key activities and sub-activities are identified using background information gathered on the company from various sources. The risk-focused surveillance process promotes the use of a "top-down" approach to identify activities. Key functional activities are considered to be key business processes or business units within a company. Once these are identified, the key sub-activities of these units can be identified. This process would continue until the examiner has obtained the level of detail necessary for understanding the activity within a particular company. Previously completed Insurer Profile Summaries and the assessed prioritization will be useful starting points to this process.

Phase 2: Identify and assess inherent risk in activities: In Phase 2, the examiner, with the assistance of the analysis staff, would identify and document the inherent risks of the insurer being examined. The examiner may identify risks from the insurer's own risk assessment (including work performed in support of MAR requirements), internal and external audit risk assessments, filing requirements of the Securities and Exchange Commission (SEC) and the Sarbanes-Oxley Act of 2002, interviews with management, and any other source. Nine risk classifications have been identified to assist regulators in classifying the inherent risks: Credit, Legal, Liquidity, Market, Operational, Pricing/Underwriting, Reserving, Reputation, and Strategic (see Exhibit L – Assessment of Controls). Once the primary risks are identified within the key business units, the examiner utilizes professional judgment to assess the inherent risk by determining the likelihood of occurrence and magnitude of impact to obtain the overall inherent risk assessment.

Phase 3: Identify and evaluate risk mitigation strategies/controls: Phase 3 requires the examiner to identify and evaluate controls in place to mitigate inherent risk. The internal controls should be assessed by how well they mitigate identified inherent risks. Risk mitigation strategies/controls generally consist of: (1) management oversight, (2) policies and procedures, (3) risk measurement, (4) control monitoring and (5) compliance with laws and regulations. The overall assessment reflects the examiner's determination on how well the controls mitigate inherent risk. Under both SOX and MAR, corporate management is clearly responsible for establishing and maintaining an adequate internal control structure and procedures for financial reporting. Under SOX, the external auditor must also attest and provide an opinion on the reliability of management's assertion on the adequacy of the financial reporting controls. Information prepared to comply with either of these requirements, when available, can assist the examiner in identifying and assessing risk mitigation strategies/controls.

Phase 4: Determine residual risk: Phase 4 requires the examiner to determine the residual risk for individual risks identified to arrive at an overall residual risk. The assessment is made by determining how well controls reduce the level of inherent risk for each risk identified. Assessing residual risk is the key to determining where the risks exist in the insurer's business. Once the riskier activities are identified, the examiner may use these results to determine where to focus examiner or analyst resources most efficiently and to determine the nature and extent of testing.

Phase 5: Establish/conduct detail examination procedures: After completion of the risk assessment for an activity, the nature and extent of detail examination procedures can be determined and performed.

Phase 6: Update prioritization and supervisory plan: Phase 6 requires relevant material findings from the risk assessment effort and any other examination activities to be utilized and incorporated into determining or validating the assessed prioritization of the insurer as well as establishing the ongoing supervisory plan.

Phase 7: Draft examination report and management letter based upon findings: Phase 7 requires the Examination Report to contain the findings related to the scope of the examination. The Management Letter may contain results and observations noted during the examination that should not be contained in the public report. This letter serves as a vehicle for ongoing dialogue between the regulator and the insurer and should be shared with those states in which an insurer is licensed, if it remains confidential.

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F. Application of the Risk-Focused Surveillance Cycle

The concepts presented in this Handbook can be applied to all examinations; however, modifications may be warranted based upon the nature and size of specific entities. Recognizing that there is a great deal of variation in the size, and complexity of insurers, this Handbook was crafted to provide some flexibility to enable examiners to react to varying circumstances. There will be a wide degree of variability in the risks faced by insurers and in the information available for examiners to review in conducting their risk assessments. Regardless of the size of the insurer, it is important for examiners to consider whether, or how effectively management identifies, assesses and mitigates risk in order to incorporate such consideration into the examination plan. As such, although the risk-focused process may be accelerated for small or medium sized companies, the risk-focused cycle illustrated within this Handbook should be used to determine the extent of residual risks.

The risk-focused examination approach should be an asset to examiners in understanding a company and planning the examination to focus on key risks. Once examinations are fully implemented in accordance with this approach, examiners and analysts should continue to maintain this approach as an ongoing process in order to stay informed of organization or external changes that will impact the company and their identified risks. If implemented in this manner, examiners should be able to maintain efficiencies when conducting examinations as they utilize knowledge gained in previous exams, and from the analyst's ongoing monitoring, to be aware of key changes and risks at the onset of examinations.

Additionally, this Handbook encourages examiners to utilize the risk management procedures within a company in identifying and assessing risks. Care should be taken by the examiners to understand the limitations of the company's risk assessment management processes in completing examinations using this risk-focused examination approach.

G. Confidentiality

The NAIC Model Law on Examinations (or a substantially similar provision) is required to be part of state law in accordance with accreditation guidelines. This Model Law provides specific guidelines regarding the confidentiality of information developed, received or disclosed through the course of conducting financial and market conduct examinations, including the course of analysis. As detailed within this Model Law, documents, materials, or other information, including but not limited to all working papers, and copies thereof, created, produced or obtained by or disclosed to the commissioner or any other person in the course of an examination, or in the course of analysis by the commissioner of the financial condition or market conduct of a company shall be confidential by law and privileged and shall not be subject to public disclosure, shall not be subject to subpoena, and shall not be subject to discovery or admissible in evidence in any private civil action.

In accordance with the revised risk-focused surveillance approach contained within this Handbook, it is anticipated that the financial examiners will be incorporating new tools to document their examination approach and results (e.g., Insurer Profile Summary, Risk Assessment Matrix, Supervisory Plan and Summary Review Memorandum). Similar to other documentation completed in accordance with a financial condition examination, these tools shall be considered confidential under state law including the state's examination law. Although the risk-focused examination approach envisions enhanced communication between state insurance department examiners and analysts, the sharing (and potential further development) of these examination workpapers to and by financial analysis regulators, or to other individuals within a state insurance department, shall not impact their confidential status. All examination workpapers, including those mentioned above, may be shared with other regulators whose state insurance departments have the authority under state law to preserve the confidentiality of the information they receive. (The confidentiality provisions related to examination workpapers apply to both examinations of insurance companies and holding companies.)

State insurance departments that utilize contract examiners should continue to remind such examiners of the responsibility to keep insurer-specific information confidential. Furthermore, the communication of effective practices employed by one insurer (whether it is a practice pertaining to the development or marketing of specific products, established controls, documentation of activities, etc.) to other entities may be perceived as a violation of trade secrets and should be restricted by both state and contract examiners.

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H. Relationship to the Market Conduct Surveillance System

The financial condition examination system focuses on financial and corporate matters. The market conduct portion of the examination system focuses on such areas as sales, advertising, rating, and the handling of claims. Market conduct compliance issues can have a significant effect on legal and compliance risks, which in turn can create material solvency issues. Coordination with the market conduct function is an important area for examiners to understand. Guidance over market conduct examinations is provided in the *Market Regulation Handbook* and is available through the NAIC.

I. Updating the Handbook

This Handbook will be updated and bound each year for distribution. Updates to the Handbook that are adopted periodically throughout the year, and various word files for exhibits will be posted on the NAIC Web site. Instructions for accessing the updates on the web page are located at the front of the Handbook. In addition to this bound book, the *Financial Condition Examiners Handbook* is available in an electronic PDF format, and certain segments of the Handbook are included within NAIC developed TeamMate TeamStores. Updates to these sources will be completed annually.

Examiners faced with the day-to-day responsibility for detecting financial difficulties can make a valuable contribution to the continuing improvement of the Handbook by submitting recommendations to the NAIC Financial Examiners Handbook Technical Group. Furthermore, changes in the *Accounting Practices and Procedures Manual* and Model Laws Regulations and Guidelines may require periodic Handbook revisions.

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SECTION 1—GENERAL EXAMINATION GUIDANCE

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I. EXAMINATION OVERVIEW

This section of the Handbook addresses the following subjects:

A. Exam Classifications Defined
B. General Procedures for Scheduling an Examination
C. Coordinating Examinations of Multi-State Insurers
D. Coordination of Holding Company Group Exams
E. Review and Reliance on Another State's Workpapers
F. Examinations of Underwriting Pools, Syndicates and Associations
G. Special Financial Condition (E) Committee Examinations
H. Limited-Scope Examinations
I. Interim Work

A. Exam Classifications Defined

Each financial examination has unique characteristics based on the type of insurer being examined and the type of examination being conducted. The following definitions will assist an examiner in classifying and understanding what type of financial exam will be performed.

Insurer Type:

- A multi-state insurer is defined as a company that is domiciled or chartered in one state and licensed, registered (for risk retention groups), qualified or accredited (for reinsurers), eligible (for surplus lines) or operating in at least one other state. For purposes of this definition, the term "state" is intended to include any NAIC member jurisdiction, including U.S. territories.

- A single-state insurer is defined as any company that does not meet the definition of a multi-state insurer.

Examination Scope:

- A full-scope examination is defined as a financial exam in which the scope of the control testing and additional detail procedures to be performed during the examination is based on the implementation and documentation of the risk assessment procedures required under this Handbook. A full-scope examination results in issuance of an examination report.

    - Interim work may be utilized during the period between full-scope examinations to focus efforts on areas that are considered inherently risky, but are not known to present an immediate concern. This work is performed in support of a full-scope examination and must, therefore, be performed in a manner consistent with the seven-phase process. A separate examination report is not required in the interim period as information deemed appropriate for report purposes will be included within the full-scope examination report.

- A limited-scope examination is defined as a financial exam, which is limited to a review or examination of particular risk areas with a known or indicated concern as determined on a basis other than the implementation and documentation of the risk assessment procedures within this Handbook. It is narrowly focused on a specific area or areas of an insurer, such as a particular key activity or process, which require immediate attention. A limited-scope examination will result in issuance of an examination report as described in Section 1, Part X E of the Handbook.

Examination Type:

- An individual examination is defined as a financial exam over one insurer.

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- A group examination is defined as a financial exam over more than one insurer. This type of exam is typically conducted when multiple companies in a holding company group have similar key processes, systems and/or management.

The classifications in each of the categories defined above are mutually exclusive.

An examination may also be classified as a coordinated exam which is defined as a financial exam that is performed by examiners from more than one state. A coordinated exam can be conducted on either one insurer or a group of insurers. In the case of the latter, this would be called a coordinated group examination. In most cases, a coordinated exam would be conducted on a group of related multi-state insurers. However, a coordinated exam could also be performed on a mix of multi-state and single-state insurers or a group of single-state insurers only such as a group of HMOs.

B. General Procedures for Scheduling an Examination

In general, examinations of domestic companies are scheduled by the domiciliary state. Within the time framework established by state law, financial condition examinations should be scheduled to ensure more frequent examinations of companies that are likely to be financially troubled or in violation of laws relating to financial condition or corporate conduct. As discussed in later sections, although each licensed state has the authority to conduct an examination, the NAIC encourages states to leverage off of the examination conducted by the domiciliary state or participate in a coordinated examination of a multi-state insurer in lieu of conducting a separate examination. General procedures for scheduling an examination are as follows:

1. Set examination priorities by considering the Insurer Profile Summary and the state's prioritization assessment. Subject to state law, insurance departments have some discretion as to the timing, frequency and scope of examinations. It is imperative that the examination schedule be balanced to focus resources on companies that are likely to be financially troubled. This can be reasonably accomplished by taking advantage of other techniques, information and resources available to the insurance department, including but not limited to the following:

    a. Increase the number of limited-scope examinations.
    b. Use of IRIS results, Examination Jumpstart, Analyst Team Reports, work performed by the financial analysts, etc.
    c. Use of reports and working papers from the company's independent accounting firm and actuary.
    d. Reference to audit adjustments recognized by the company's independent accounting firm. (Documentation of CPA identified adjustments may be obtained directly from the company.)
    e. References to any internal control letters furnished by the company's CPAs.
    f. Findings of reviews of company financial statements performed by other departments or NAIC personnel. The department may have a financial analysis team that reviews filed annual and quarterly financial statements and performs analytical procedures such as those indicated in the *Troubled Insurance Company Handbook* and the *Financial Analysis Handbook*. Any significant findings from this process should be added to the examination scheduling criteria.

    Considerable judgment will always be necessary to determine the optimal timing, frequency and scope of examinations. The following additional items, though not all-inclusive, should be considered:

    a. Has a change in management occurred since the last full-scope examination?
    b. Has the company been identified as a "priority" company by the IRIS results or supplemental internal department or NAIC financial analytical reviews? Has there been a significant adverse shift in the results of these tests? (Unless further analysis indicates the results are misleading for some clearly identified reason).
    c. Results of past full-scope, limited-scope and market conduct examinations, including recommendations for timing and extent of follow-up procedures contained therein.
    d. Information from other states or outside sources.
    e. Concentration of business in high-risk lines, or concentration of assets.
    f. Significant changes in operating results or mix of business.

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g. Unusual disclosures in the independent accountant or actuary's report.
h. Evidence of surplus aid other than financial reinsurance agreements.
i. Unusual disclosures in the notes to the filed statutory financial statements or the audited financial statements, Form 10K, or other filings, particularly regarding loss contingencies.
j. Nature of any items communicated in material misstatement letters furnished by independent accountants.
k. External environmental considerations, such as a significant downturn in a regional real estate market or securities markets, or the insolvency of a significant reinsurer that may have assumed business from companies operating in the states. Reference should be made to the NAIC's Financial Condition Examination Risk Alert and similar publications, such as the AICPA's Audit Risk Alert, for items of current significance regarding examinations and audits of insurance companies.
l. Other non-financial criteria, such as input from other areas within the department including consumer complaints, market conduct, legal, etc.

2. Call the examination using the NAIC Financial Exam Electronic Tracking System (FEETS). All examinations on multi-state insurers should be called using FEETS. An exam on a single-state insurer should also be called in FEETS if that insurer is part of a holding company group.

3. Estimate staffing requirements for each examination:

   a. Project total hours based on previous experience and current issues that have been identified.

      (1) To facilitate future estimates, a record of examination hours should be filed with the department at the completion of the examination.

      (2) The chief examiner or designee should review the previous experience when scheduling a new examination and estimate the total person days required, adjusting for:

         - Variance between budgeted and actual time required to complete tasks.

         - Special circumstances affecting the new or previous examination. Particular consideration should be given to the impact of the risk-focused examination process that may increase or decrease the amount of time required for individual areas based on the key activities determined and the residual risks expected. Consideration should also be given to the time savings anticipated by increased use of reports and working papers from independent accountants and actuaries, as well as company internal audit department and direct assistance from company personnel preparing schedules and pulling documents. In addition, the scope of the current examination may be different (limited vs. full-scope).

         - Changes in the company's size or recordkeeping systems.

   b. Determine the staff size and skills required, considering:

      (1) Staff needed to complete the examination in a reasonable period of time.

      (2) Technical skills required to:

         - Apply statistical sampling techniques.

         - Evaluate and work with computer-based record systems.

         - Examine reserves and reinsurance contracts.

         - Resolve issues related to other areas demanding specialized knowledge.

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- Address limited-scope examinations that will likely be focused solely on areas that are more complex and more judgmental, and, therefore, require more expertise.

(3) Professional qualifications and designations

- Examinations of single-state insurers – There is no requirement for an examiner-in-charge to hold the title of Certified Financial Examiner (CFE) as certified by the Society of Financial Examiners. However, it is considered a best practice.

- Examinations of multi-state insurers – The examiner-in-charge must hold the title of CFE as certified by the Society of Financial Examiners or be directly supervised by someone holding the CFE designation. Any non-domestic examiners participating in these examinations must hold the title of either an Accredited Financial Examiner (AFE) or CFE as certified by the Society of Financial Examiners.

4. Estimate the time required to complete the examination by dividing the total number of person days plus administrative (e.g., training plus vacation) by the staff size.

5. Project start and completion dates of each examination.

   a. List all companies by priority classification and determine the appropriate scope of examination (full-scope vs. limited-scope). A company may not be considered high priority for a full-scope examination, but may receive high priority as a limited-scope examination because of particular circumstances, such as a large receivable from a troubled reinsurer, or a significant contingency such as outstanding litigation.
   b. Project available staff by month.
   c. Record time and staffing required to complete examinations already in progress.
   d. Record time and staffing required for examinations of holding company units called by the group/subgroup Lead State.

6. Quarterly Updating of the Schedule

   a. Adjust priorities, if necessary, to reflect additional information on the likely financial condition of domestic companies.
   b. Adjust scheduling of examinations to reflect:
      - Updated projection of available staff.
      - Differences between actual and previously projected time required to complete in progress examinations.

C. Coordinating Examinations of Multi-State Insurers

The opportunity for states to perform a coordinated exam of individual insurers licensed and/or operating in multiple states is not intended to preempt states' legislative and regulatory authority in conducting financial examinations. This approach creates a vehicle for a representative number of states to adequately plan and devote resources when conducting financial examinations of insurers licensed in more than one state (multi-state insurers). It also allows independent perspectives on examination issues by those regulators participating in the financial examination. Examinations of multi-state insurers shall include verification of the payment of taxes by the company to the respective states in which it is licensed, in addition to determining the solvency of the company and the manner in which it conducts its affairs.

In order for examinations to be accepted by other states, the NAIC *Model Law on Examinations* (#390) states that at least one accredited state participate in each examination performed on a multi-state insurer.

Typically, the domiciliary state determines the need for an examination. The NAIC requires the full use of the NAIC Financial Exam Electronic Tracking System (FEETS) when calling examinations on multi-state insurers and recommends

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the use of FEETS for all examinations. Examinations on multi-state insurers should be called in FEETS at least 90 days before the anticipated start date of the examination. When calling the exam in FEETS, the calling state inputs the requisite data regarding the examination.

Once the exam is called in FEETS, an email notification will be sent to any state in which the insurer is licensed (or registered for risk retention groups (RRGs)) or writing business in based on Schedule T of the insurer's Annual Statement. The email will serve as an invitation (except for RRGs) for those states to participate on the exam.

The NAIC also recommends coordinating examinations of risk retention groups (RRGs) operating in multiple states, but only to the extent that the other states are notified of an upcoming examination. The federal Liability Risk Retention Act of 1986 neither requires nor prohibits non-domestic states to participate on examinations of RRGs. Therefore, the domestic state is required to notify the other states of an upcoming examination but is not required to invite the other states to participate on the examination.

Although a state may be invited to participate, the state should have a valid regulatory reason as it relates to the company's operations before agreeing to participate. State participation should focus on insurer and insurer functions that pose the greatest risk exposure. In an effort to reduce examination inefficiencies, a valid regulatory reason should be provided by the state requesting participation in the examination. Valid regulatory reasons for participation include, but are not limited to the following:

1. Material financial concerns exist with the insurer. A concern is "material" if, in light of surrounding circumstances, the magnitude of the item is such that it is probable that the judgment of a reasonable person relying on the statutory financial statement would have been changed or influenced by the inclusion or correction of the item.

2. The insurer is subject to a disproportionately high number of consumer complaints.

3. Specific concerns with potential fraud supported by appropriate documentation.

4. Premium volume, if the insurer writes a material amount of business in the state (at least 10% of the insurer's annual premium must be written in the state requesting to participate). A state that has either a material amount of premium volume or a large percentage of the outstanding loss and loss adjustment expense reserves should be presumed to have a justified interest to participate in the examination.

5. The calling state requests help due to resource issues. In requesting help, cost should be considered, but is not required to be the ultimate factor in determining whether non-domestic participating examiners, consultants or contract examiners should be utilized on the exam.

Providing work to keep an examiner busy is not a valid regulatory reason to participate on a coordinated examination.

States that receive an email notification of a called examination must make a decision as to participation. If the state does not wish to participate, no action is required. However, if a state would like to participate, it should contact the calling state for approval within 14 calendar days from the calling date. It is recommended that this be performed via email, thus creating a communication exchange that can be documented in the exam workpapers. At a minimum, the information that should be included in the request to participate includes:

a. Current date.

b. Name and examination number of company to be examined.

c. If already determined, contact information of examiner to participate.

d. The valid regulatory reason for participation.

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As a general recommendation, participation in exams on multi-state insurers should typically be limited to one state per zone. In order for the calling state to pick the most qualified examiner(s) based on valid regulatory reasons, the calling state should wait 15 calendar days from the calling date in order to allow the invited states time to respond to the email notifying states the exam has been called. The calling state then has five calendar days from the date of receiving any participation request(s) to evaluate those request(s). The calling state should base its decision whether any other states will participate on the exam primarily on the valid regulatory reason(s) those states provide. If a request to participate is received after the 15 calendar days from the calling date, the calling state can still evaluate the request but should also determine how the participation from another state will affect the timing of the exam.

If the calling state approves the participation of another state, the calling state should communicate the approval (usually through email) back to that state to begin the coordination process.

The calling state has the ability to decline state participation in the absence of a valid regulatory reason. If participation is denied, the state requesting to participate may request exam arbitration by contacting the zone coordinator of its respective zone. The zone coordinator must receive the request for exam arbitration within 10 calendar days of being notified that participation was denied. The zone coordinator will then have 15 calendar days to resolve the participation dispute between the calling state and the state requesting participation.

The Financial Condition (E) Committee has divided the United States and its territories into four zones:

STATES BY ZONE

NORTHEAST ZONE

Connecticut
Delaware
District of Columbia
Maine
Maryland
Massachusetts
New Hampshire
New Jersey
New York
Pennsylvania
Rhode Island
Vermont

SOUTHEAST ZONE

Alabama
Arkansas
Florida
Georgia
Kentucky
Louisiana
Mississippi
North Carolina
Puerto Rico
South Carolina
Tennessee
Virgin Islands
Virginia
West Virgin

MIDWEST ZONE

Illinois
Indiana
Iowa
Kansas
Michigan
Minnesota
Missouri
Nebraska
North Dakota
Ohio
Oklahoma
South Dakota
Wisconsin

WESTERN ZONE

Alaska
American Samoa
Arizona
Montana
Nevada
New Mexico

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California	N. Mariana Islands
Colorado	Oregon
Guam	Texas
Hawaii	Utah
Idaho	Washington
	Wyoming

If the starting date of a called examination is either postponed or canceled, the state calling the examination shall immediately notify the impacted states. Such notification should include comments relative to the postponement or cancellation.

Although examinations on rating, advisory, service or statistical organizations cannot be called in CEETS, the calling state should notify and invite the other states that the organization is operating in that the exam will be conducted. This would typically be executed through an email to the other states.

D. Coordination of Holding Company Group Exams

A coordinated group examination should attempt to be a comprehensive and simultaneous examination of insurance entities in a holding company group, which may be domiciled in multiple states. The phrases "holding company group" and "group" are used interchangeably throughout this section and are meant to include insurers that meet the definition for inclusion in an "insurance holding company system" as defined in the *Insurance Holding Company System Regulatory Act* (#440), as well as other groups under common control that do not meet this definition but would benefit from coordinated examination efforts. Coordination among the states should include the timing, scope and extent of examination procedures, utilization of specialists (e.g., information systems and actuarial) and their work products, and allocation of work among examiners. This coordination promotes communication among the states and the efficient use of resources, provides an avenue for multiple perspectives to be shared, and minimizes the duplication of work.

Exam coordination among insurers of a group or holding company system is critical for effective solvency regulation. When examinations are conducted on a group of insurers, the goal is to gain efficiencies and prevent duplication of testing wherever possible. Group examinations not only provide information on each insurer individually, but also provide an avenue for regulators to understand and evaluate the risks of the holding company group as a whole. Under Model #440, regulators have the authority to examine "any insurer registered under Section 4 and its affiliates to ascertain the financial condition of the insurer, including the enterprise risk to the insurer by the ultimate controlling party, or by any entity or combination of entities within the insurance holding company system, or by the insurance holding company system on a consolidated basis." Therefore, in conducting a coordinated group exam, the lead state or exam facilitator should work with the assigned financial analyst to identify and address any significant concerns at the group level with the potential to threaten the solvency of the insurers being examined. In this situation, a group examination report may be issued by the lead state, but does not reduce the need to obtain evidence about the solvency of each insurer or eliminate requirements for individual examination reports.

States should coordinate examinations of all types of insurers operating in holding company groups when possible, including health insurers that operate primarily as health maintenance organizations (HMOs). Even though these organizations are often composed of single-state entities, they could still share processes, controls and decision-making that might be more efficiently reviewed through a coordinated group examination.

Before, during and after a group examination, the Lead State, Exam Facilitator and any other regulators that have domestics in the group—whether participating in the group exam or not—should be prepared to discuss relevant information with the NAIC Financial Examiners Coordination (E) Working Group. This information could include, but is not limited to, scheduling a group exam, the progress of a group exam, and why coordination did or did not occur between states for a particular group.

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Determining the Lead State and Subgroups of Companies

Every insurance holding company system has individual characteristics that make it unique. Therefore, an evaluation of traits is required to determine how examinations for the group should be coordinated and which individual state should assume the leadership role in coordinating group examinations. The state assigned this responsibility will be known as the Lead State and is charged with the coordination of all financial exams for the holding company group, as well as other regulatory solvency monitoring activities as defined within the Financial Analysis Handbook.

In most situations to date, the Lead State has emerged by mutual agreement (i.e., self-initiative on its part and recognition by other states), generally as a result of the organizational structure of the group or as a result of the domiciliary of primary corporate and operational offices. The input of domestic regulators within the group also plays critical role in determining which state should be chosen to fulfill the role of the Lead State. Other factors that may be considered when determining the Lead State are:

- State with the largest number of domestic insurance companies in the group.
- State of large or largest premium volume or exposure.
- Domiciliary state of top-tiered insurance company in an insurance holding company system.
- Physical location of the main corporate offices or largest operational offices of the group.
- Expertise in the area of concern and experience of staff in like situations.
- State whose regulatory requirements have driven the design of the organization's infrastructure.

Input from domestic regulators in the group, as well as holding company personnel, should be considered when determining how the companies in the group might be broken up into subgroups for financial exam purposes, if necessary. Because each group has its own unique characteristics, as do the companies within each group, it might be appropriate to separate the group into smaller factions and identify an Exam Facilitator for each subgroup examination. In order to gather information to make this decision and to assist in planning the coordinated examination, the Lead State might request that holding company group personnel provide information to be considered in grouping companies within the holding company group for financial examinations. At a minimum, the information provided should include the topics of corporate governance of the group, risk management and decision-making, key functional activities and processes, and computer systems. This information request is also included in Exhibit Z, Part One.

Responsibilities of the Lead State

The primary purpose of the Lead State is to promote the coordination of exams for all entities within the group. In achieving this goal, the Lead State should fulfill the following responsibilities:

1. Monitor the status of existing examinations performed on all entities within the group – This requires the Lead State to have an understanding of the progress of all ongoing exams and to understand the significant results of all recently completed exams. If consistent problems are identified during examination efforts, the Lead State may need to become involved in addressing the issues at the group level.

2. Identify subgroups that may be appropriate for performing coordinated examinations – In situations where it is not feasible for all legal entities within a group to be examined at one time, the Lead State should play the primary role in determining which entities should be grouped together for examination purposes. The Lead State should use input from the company including responses to Exhibit Z, Part One in making this determination. In addition, the Lead State should receive input from other domestic regulators within the group when making this decision. However, it is the Lead State's responsibility to determine subgroups for ongoing examination coordination purposes.

3. Encourage participation from all states within the group – The Lead State should actively encourage all states within the group to participate in coordinated group examinations when possible. To help facilitate participation by all states, the Lead State should develop and maintain a global coordination plan, which could include information about potential subgroups, anticipated schedule, primary location of fieldwork, etc. Such a plan

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would allow ample time for the states to make the necessary arrangements to participate in future coordinated efforts. The Lead State should be prepared to discuss relevant information pertaining to the global coordination plan and the status of coordination efforts with the NAIC Financial Examiners Coordination (E) Working Group as requested. If selected, the Lead State would be required to present such information to the Financial Examiners Coordination (E) Working Group at an NAIC national meeting.

One tool that can be used to help facilitate participation and the development of a global coordination plan is the Group Exam Report in the NAIC Financial Exam Electronic Tracking System (FEETS). The Group Exam Report assists regulators in actively communicating and tracking scheduled examinations for insurance company groups. The report also allows for changes to the examination schedule that may occur as a result of changes to company operations and financial condition. The group examination schedule should not preempt consideration of a state's prioritization schedule or postpone examinations of troubled companies, nor should it interfere with the state's obligation to conduct a full scope examination of its domestic insurance companies in accordance with state statutes.

4. Notify other regulators and the companies in the group of an upcoming examination – The Lead State should notify other states that have domestics in the group of the exam well in advance of significant planning work to allow them the opportunity to participate on the examination. An informal notification to the other state regulators should occur as early as possible and is recommended at least six months prior to the "as-of" date (e.g., 12/31/20xx). In most circumstances, the formal calling of the group examination in FEETS should occur at least 90 days before the anticipated start date of the group examination by the Lead State. The timing difference between the informal notification and the calling in FEETS allows the Lead State time to determine specific attributes of the group exam, such as the primary contact person and the anticipated start date of the exam that may not be known six months before the "as-of" date. If an exam is scheduled due to specific concerns with a group of companies that do not allow the exam to be called in FEETS at least 90 days before the anticipated start date, the Lead State should document an explanation for inclusion in the group exam workpapers and notify other state insurance regulators as soon as possible.

   The Lead State or Exam Facilitator (if known at this time) should also notify the companies that will be examined as part of the group examination to allow them and their respective external auditors time to prepare. This notification should occur at least six months before the "as-of" date of the group examination.

5. Call group examination(s) in FEETS and determine the Exam Facilitator for each group examination called – One of the first responsibilities of the Lead State when a group exam is planned is to call the group examination in FEETS and to determine who will perform the role of Exam Facilitator. In many situations, it is expected that the Lead State will assume the Exam Facilitator role itself to conduct and lead the group examination. However, in situations where subgroups have been formed that don't involve the Lead State, it is anticipated that the Exam Facilitator role will be delegated to an accredited state within the group. If the responsibility is delegated, the accepting state would then assume the responsibilities associated with conducting that group examination. The role of Exam Facilitator is typically temporary in nature because it pertains only to a specific group examination being performed; once that exam has been closed, the need for an Exam Facilitator is no longer present and any assumed responsibilities remit back to the Lead State (if they were delegated). For some groups that maintain clear long-term subgroups, the Exam Facilitator role may be more permanent. The selection of the Exam Facilitator can be accomplished through a review of the documentation provided by the holding company group personnel and through discussions with the impacted states. The regulated entities should also be allowed to provide input on the Exam Facilitator determination process where appropriate. The designated contact person should be the chief examiner, or equivalent, for the Exam Facilitator of each group exam.

   Please Note: Due to the design of FEETS, the Lead State will always call the exam in FEETS regardless of whether there is a different state designated to facilitate the group exam.

6. Act as the Exam Facilitator for all group examinations as deemed appropriate – The responsibilities associated with this role are outlined later in this section.

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7. Maintain communication with the group personnel to discuss exam coordination progress and other significant examination issues – The Lead State should serve as the primary regulatory contact with top management of the group on an ongoing basis regarding overall coordination activities for companies within the group. Additionally, the Lead State is responsible for elevating significant solvency concerns to top management of the group when issues are unable to be resolved at lower levels within the group.

Additional Considerations for Scheduling a Coordinated Group Exam

For each holding company group, consideration should be given to the priority of each entity within the group when determining the frequency at which group examinations should be performed. The Lead State should obtain input from all of the key domestic regulators within a group (or subset of companies) before determining the "as of" date for the next examination. This input may be obtained through the use of a supervisory college, conference calls conducted through the financial analysis process, or other meetings to discuss the financial regulation of a particular group. In addition to basing the frequency of full-scope group examinations on the financial strength of the group, regulators should consider performing limited-scope exams when specific concerns arise with the holding company group. Whenever conclusions are reached regarding the scheduling of full or limited-scope group examinations, prompt notification should be provided to all states with domestics in the group (or subset of companies) to enable all domestic states the opportunity to participate in the group examination.

The chief examiner of the Lead State or designee is responsible for placing the group examination call to simultaneously examine the entire group (or subset) of insurance companies involved in an insurance holding company group. It is recommended that all group examinations be called in FEETS regardless of what type(s) of insurers are being examined. For example, if a group exam is being conducted for a group of RRGOs that are all single-state entities, the group exam should still be called in FEETS for informational and tracking purposes. Specific requirements regarding calling an exam in FEETS can be found in the "Responsibilities of the Lead State" section above.

Unaffiliated entities that have significant influence or could materially impact insurers in the group should also be considered for inclusion in the group examination. The examination of companies that are members of a holding company system having only a reinsurance relationship with the company under the examination may be conducted on a limited basis to verify the complete nature of transactions (obligations, liabilities and assets transferred between parties).

Responsibilities of the Exam Facilitator

The role of Exam Facilitator will vary from exam to exam; however, certain responsibilities assigned to this role are shown below. The Exam Facilitator for all examinations must be an accredited state.

1) Develop an examination team – Once it has been determined that a coordinated group exam will be conducted, a determination should be made of all of the states that will have a direct role in the examination. The Exam Facilitator should determine the necessary staffing requirements for the specific examination at hand.

   While developing the exam team for a group examination, the Exam Facilitator should coordinate and utilize any available resources (within the group or contracted) that are necessary and appropriate to complete an effective and efficient examination. These may include, but are not limited to, financial analysts, financial or market conduct examiners, IT examiners, actuaries, legal counsel, rate and form experts, or valuation experts. Consideration should be given to the areas of expertise needed to complete the examination. If possible, states participating in the group exam should consider utilizing the same staffing resources when efficient to do so. For example, it may be efficient to utilize the work of one actuary who could become familiar with the general processes utilized by the group of insurers instead of contracting several different actuaries who would all have to familiarize themselves with the same processes.

   The Exam Facilitator should contact the participating states to establish points of contact by name/role, determine the amount of interest in participating in the coordinated examination, and establish lines of communication with participating states. Preferably, the Exam Facilitator should designate a primary and a back-up point of contact for communications with the organization under review and with other state regulators, Federal Reserve, federal and

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state banking agencies, functional regulators and the public. At a minimum, information for the primary contact person must be provided for the group exam in FEETS.

2) Seek input from other regulators – During the planning stages of an exam, the Exam Facilitator should request input from other regulators regarding any areas of concern that should be addressed during the group exam. Input should be requested from any states with domestics in the group or subgroup, as applicable, even if a state is unable to participate in the fully coordinated exam. This responsibility includes obtaining input from each state regarding the key activities and inherent risks it anticipates for each of its domestic companies. Consistent with the guidance in Phase 1, identification of key activities and risks should primarily be determined by areas that represent significant solvency concerns. The Exam Facilitator should also contact regulators of holding company groups that include an entity or entities that are at least in part regulated outside the state insurance regulatory structure for items to consider or address during the examination.

   Once the Exam Facilitator has accumulated information from each regulator, in addition to information related to its own domestics, it should determine which key activities/inherent risks will and will not be addressed as part of the group examination and notify the other state insurance regulators. Testing performed by participating states in areas deemed insignificant to the overall group examination are considered state-specific procedures and, therefore, the oversight of such work is outside of the Exam Facilitator's responsibility.

3) Delegate responsibilities among the examination team – Once the multi-state "team" has been established, the Exam Facilitator should clearly delegate responsibilities between itself and any participating examiners. The Exam Facilitator should manage information requests going to holding company group personnel to prevent redundancy. It should also attempt to coordinate the testing of work that will be performed by all states participating on the group exam to the extent possible. This includes organizing a review of shared processes and controls and determining which state(s) are responsible for which key activities and processes. When delegating responsibilities, the Exam Facilitator should consider the resources needed and available for the task among the participating states as well as the expertise and ability to supervise personnel as necessary.

   One of those responsibilities includes meeting with internal and external auditors. The Exam Facilitator should complete Exhibit E – Audit Review Procedures for the group examination. The Exam Facilitator should also coordinate the communication of obtaining and reviewing any relevant auditor workpapers to prevent redundancy between states.

   In Phase 5, detail testing may be necessary to obtain additional exam evidence for any particular identified risk. With input from the participating states, the Exam Facilitator should determine whether detail testing will be performed as part of the group examination or if the testing will be performed separately by each domestic regulator. Regardless of which method is used, if detail testing will involve substantive testing of individual account balances, the testing should be applied at an individual company level based on the residual risks determined during the group exam (assuming the identified risk was one that was assessed during the group exam). In other words, the materiality levels for each individual company should be utilized when selecting what substantive testing should be performed so that exam evidence will be obtained for each insurer based on its dollar value. However, if detail testing will consist of testing the attributes (or accept/reject testing) of underlying data utilized in other calculations (e.g., loss reserves, unearned premiums), the testing may be performed at the group level because the examiner is testing the occurrence of a particular attribute in a population subject to the same control processes. For pooling arrangements, see the "Exceptions to Consider Related to Coordinating Group Exams" section below.

4) Establish lines of communication with top management in the group related to the group exam being performed – The Exam Facilitator should ensure that there are regular and candid discussions with top management of the insurance companies regarding the results of the ongoing group examination. A structure for obtaining updated information from company management regarding the ongoing exam should also be established. If significant solvency concerns arise that are unable to be resolved by the Exam Facilitator, the issue should be raised to the Lead State, if different, to address with top management of the group.

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5) Obtain a thorough understanding of the companies being examined as part of the group exam as they relate to the organization as a whole – The Exam Facilitator should obtain as much insight as possible into the organization as a whole when leading a coordinated group exam effort. To gain this understanding, the Exam Facilitator should focus on the holding company, or ultimate controlling entity, and subsequently on its underlying subsidiaries that will be included in the group exam. The Exam Facilitator should also take the predominant role in obtaining and reviewing analysis work pertaining to the organization as a whole in preparation for group exams by working with the individual domestic states and foreign regulators to complete a collective understanding of the holding company group.

6) Interview management and board members at the holding company level – The Exam Facilitator should perform interviews of the upper-level management and members of the board, and its committees, at the level at which oversight and management of the group's primary insurance activities are performed. Participating states may provide questions to the Exam Facilitator that they would like asked during interviews. These states may also participate in the interviews in limited situations when deemed appropriate. These interviews should be conducted in-person if possible, and it may be beneficial to schedule them during regularly scheduled board/committee meetings if convenient for scheduling purposes. When these interviews are completed, the information should be distributed and shared among regulators as necessary to prevent unnecessary duplication of efforts. When subgroups are utilized, the Exam Facilitator of the subgroup should consult with the Lead State to determine whether a corporate governance assessment has been performed at the holding company level and if it would be appropriate to leverage at the subgroup level.

7) Share information with participating states during the group exam – Procedures should be established regarding how information will be shared, including ensuring that all participating states have real-time access to the information. This step is critical to establish the Exam Facilitator as a true "facilitator" by supplying the states and other functional regulators with the appropriate information. This can be accomplished through verbal or written updates from the Exam Facilitator to the broader group of state insurance regulators. Real-time access of workpapers could also be accomplished through the use of the NAIC Citrix server or other tools available to individual states. Insurance departments should develop methods to receive, as well as to communicate, pertinent information regarding holding companies and insurance groups to other affected states and other functional regulators.

8) Review the work performed by participating states – The Exam Facilitator should perform a sufficient level of review of work completed by participating states to gain comfort that the quality of work meets the examination objectives and the Exam Facilitator's expectations. When determining the extent of review, the Exam Facilitator should consider its comfort and experience with the quality of work performed by each participating state. The accreditation status of participating states may also be considered in determining the level of review necessary to gain comfort in the quality of the work performed. As discussed in the "Review and Reliance on Another State's Workpapers" section following this section, the Exam Facilitator is responsible for the overall quality of work performed in completion of a fully coordinated group examination.

9) Promote consistency in examination deliverables – The Exam Facilitator should communicate with all states involved in the coordinated effort to promote consistency of information shared in management letters and examination reports.

10) Distribute information to participating states and other functional regulators – Once the work of the group is completed, the Exam Facilitator is required to give all participating states an electronic copy of the corresponding workpapers related to the group examination for inclusion in the workpapers for their respective individual company exams. The Exam Facilitator should also communicate the completion of the group exam procedures to the holding company group personnel and that any work after that point is performed by individual states for their individual domestics.

The NAIC Financial Regulation Standards and Accreditation Program requires that the states allow for the sharing of otherwise confidential information and administrative or judicial orders to other state regulatory officials, providing that those officials are required, under their law, to maintain its confidentiality. The NAIC

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Master Information Sharing and Confidentiality Agreement allows for signatory states to share confidential information with another signatory state that can demonstrate that its laws will protect the confidentiality of the shared information. This agreement is designed to eliminate the need for states to sign numerous multi-state agreements on a myriad of regulatory subjects.

11) Resolve any disputes or disagreements regarding the group examination – The Exam Facilitator should settle any disagreements among participating states when conducting a group exam. If the Exam Facilitator is unable to resolve the issue at hand, it should defer the issue to the Lead State (if different than the Exam Facilitator). If the issue is not able to be resolved at that level, the Financial Examiners Coordination (E) Working Group can be consulted for timely resolution.

12) Hold an exit conference with the participating states – Once the group exam work is completed, the Exam Facilitator should host an exit conference to discuss the overall results of the group exam and possible steps for regulating the holding company group in the future. The Lead State should be invited to participate in the exit conference if they were not already participating in the examination. During this meeting, the Lead State and the Exam Facilitator should discuss with the participating states when the next group exam should be scheduled based on the topics included in the "Additional Considerations for Scheduling a Coordinated Group Exam" section above. If the regulators have difficulty coming to an agreement regarding the next group exam date, they should reach out to the Financial Examiners Coordination (E) Working Group for input and assistance.

13) Close the group examination in the NAIC (FEETS) – Upon the completion of the group examination, the Exam Facilitator should ensure that each participating state has linked its individual examination(s) to the group examination in FEETS. Once work in support of the coordinated group exam has been completed and each participating state has linked its individual examination(s) to the group exam, the Exam Facilitator should close the group examination.

Responsibilities of States Participating in a Fully Coordinated Exam

In general, the role of each participating state that is not the Exam Facilitator is to pledge some level of cooperation and coordination with other states and to give support and recognition to the Exam Facilitator. This can be accomplished in a number of specific ways:

1) Respond to the Exam Facilitator regarding participation on the group exam – The participating state(s) should respond to the Exam Facilitator within 30 days of receiving the email notification (sent by FEETS) regarding the calling of a group examination. Each participating state is encouraged to be flexible when attempting to coordinate and should consider the long-term benefits of coordination.

2) Actively participate in the planning phases of the group exam – During the planning phases, the participating state(s) should communicate key activities, inherent risks or other areas of concern for each domestic company that the participating state(s) would like to be addressed during the group exam, as well as an overview of any state-required compliance testing the participating state plans to perform. Consistent with the guidance in Phase 1, identification of key activities and risks should primarily be determined by areas that represent significant solvency concerns. The states should be notified by the Exam Facilitator which risks will and will not be addressed as part of the group examination. This information should help the state in determining whether additional risks will need to be addressed outside of the group examination efforts. Testing performed by participating state(s) in areas deemed insignificant to the overall group examination are considered state-specific procedures and, therefore, the quality of such work is the responsibility of the participating state. Active involvement in the planning phases of the exam may include documenting correspondence with the Exam Facilitator and other participating states, reviewing and signing off on the planning memo, participating in the discussion of risk identification, etc.

3) Coordinate the use of any examination resources, including contracted examiners and specialists, with the Exam Facilitator – The participating state(s) should provide specific expertise and resources to assist the Exam Facilitator and other states throughout the group examination process as requested.

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4) Offer constructive suggestions for information requests, interview questions, coordinated actions and timeliness of information – Any general communication on behalf of the group exam should be discussed with the Exam Facilitator prior to contacting company personnel to prevent duplication, if possible. This includes any information requests being sent as part of the group examination.

5) Interview individuals at the legal-entity level who are unique to the participating state's particular insurer, if necessary – The participating state(s) should also provide the Exam Facilitator with interview questions to cover during C-Level interviews performed for the coordinated group exam, if any.

6) Complete group responsibilities delegated by the Exam Facilitator to the satisfaction of the Exam Facilitator – In addition to assigned testing, such responsibilities may also include clearing review points provided by the Exam Facilitator, performing detail reviews of its own staff's testwork and other responsibilities as communicated by the Exam Facilitator.

7) Leverage work performed in fulfillment of the coordinated effort – The participating state(s) should leverage work performed in fulfillment of the coordinated effort, even when completed by other states within the group. Participating state(s) should avoid creating duplicative documentation and instead include a limited number of hyperlinks and/or key workpapers that are necessary to understand where coordinated work is located.

8) Provide adequate oversight of the work of its own staff, contract examiners, specialists and consultants – It is not the responsibility of the Exam Facilitator to supervise personnel from other states on a day-to-day basis. Each state must provide adequate oversight of its examiners, regardless of whether they are state employees or contract examiners, and should consider the allotted time that has been budgeted for the work of that state's resources. Each state will be held accountable for the performance of personnel it has scheduled on any group examination.

9) Be informed and prepared to share information and perspectives pertinent to the group examination and the respective domestic insurers – This includes actively participating in conference calls and meetings arranged by the Exam Facilitator.

10) Demonstrate participation in the exit conference hosted by the Exam Facilitator by providing any relevant information, input and conclusions on the group exam discussion.

11) At the conclusion of the examination(s), issue report(s) of domestic(s) by uploading the report(s) to FEETS and closing the exam(s) in FEETS – Upon the completion of the individual examination(s), the participating state should ensure that the individual examination(s) for its domestic(s) being examined as part of the group examination are linked to the group exam call in FEETS. The participating state must distribute the report(s) of its domestic(s) to the states in which the insurer(s) are licensed and/or transacting business by uploading the exam report(s) to FEETS. This shall occur no more than 30 days beyond the adoption date of the exam report(s). When closing the examination(s) in FEETS, include the next planned "as-of" date for each domestic that should be consistent with what was discussed during the exit conference.

Exceptions to Consider Related to Coordinating Group Exams

The Lead State should take state statutes into consideration because they may differ regarding how often a financial examination is required (e.g., three to five years). Several insurers within a holding company system with different states of domicile may be on varying cycles when their exams are performed. If it is deemed beneficial for states to participate on a group exam even though their legal entities are not yet due for an examination, those states are encouraged to accelerate their next exam "as-of" date in order to match the "as-of" date of the group examination.

In striving toward examination coordination, it is important to note that complete coordination may not improve the examination efficiencies for some groups. In some circumstances, different Exam Facilitators may separate those companies within a group on different examination coordination schedules. Regulators will be able to utilize the NAIC Group Exam Report in FEETS to assist with determining how companies within the group may have been separated into subgroups based on previous group exams performed. This is in accordance with examination coordination efforts

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illustrating that coordination efficiencies have been achieved for those companies with similar systems, management, and/or control processes across legal entities, business units or lines of business within a group.

A situation may arise where a domestic regulator has concerns about a particular insurer within a group that is not determined to be significant to the group overall. In these situations, in order to attempt to keep domestic insurers coordinated as part of a group examination, the domestic regulator should consider performing a limited-scope exam on that entity, if possible. However, if a limited-scope exam is insufficient and a full-scope examination of the domestic entity is warranted outside the normal group exam schedule, the Lead State should be notified and the examination should be performed by the domestic regulator utilizing work previously completed by the group as appropriate. After the examination is performed, the domestic regulator should attempt to coordinate future examinations with the group if at all possible.

Although a state may be unable to participate on a group examination at a certain point in time, that state may benefit from receiving group exam workpapers completed at any time during the exam period for its individual domestic exam(s). In these cases, the non-participating state should contact the Lead State and Exam Facilitator directly to obtain access to those workpapers and they should be made available. The non-participating state should have adequate time for the request to be fulfilled and for the requested workpapers to be adequately reviewed before the work is provided to the non-participating state. This does not require a review of all the exam work, but only the specific work requested so the work can be received timely. Similar to utilizing the work from external/internal auditors, if an examiner plans to utilize documentation that was performed on a group exam from a year prior to the current examination "as-of" date, the examiner should obtain evidence that the item documented (e.g., internal controls) has not changed subsequent to the prior period testing. The more reliance that is placed on the prior period documentation received from the group exam, the more examination evidence should be obtained. Verification that the item documented has not changed should be obtained by a combination of inquiry, observation, reperformance and examination of documents, and should be clearly documented in the examination workpapers. If it has significantly changed since the prior period, the examiner should not utilize the prior period workpapers for that area as examination evidence.

When conducting an examination of a group that writes 100% of its business through the use of a pooling arrangement, it may be acceptable to calculate materiality at the group level. Group materiality may be beneficial for these situations because the risks are consistently shared throughout the group, and any detail testing that is based on materiality will take all the transactions of the group into consideration. With the Exam Facilitator leading the discussion, the regulators within the group should determine if this is appropriate for the group of insurers in a pooling arrangement and if exam evidence is being obtained for all insurers under examination.

E. Review and Reliance on Another State's Workpapers

For a number of reasons, state insurance regulators have recognized a growing need to more fully coordinate their regulatory efforts. One such reason is the realization that the analysis of an individual company may not be complete without understanding the context of the insurance holding company group of which the individual company is a part. Insurers within an insurance holding company group may have common management and similar information systems and/or control processes. Therefore, if the insurer under examination is part of an insurance holding company group, the domestic state could benefit from the work of another state if that other state's examination procedures address the domestic insurer's financial statements or internal control procedures.

Depending on how the examination is coordinated, the extent of documentation required to explain the reliance of a domestic state on the work of another state varies. There are three general scenarios that may affect the extent of documentation.

1) Lead State/Exam Facilitator conducting a fully coordinated group examination – When the group examination is conducted in this manner, the Lead State/Exam Facilitator is responsible for the overall quality of the work performed in support of the coordinated exam conclusions. Any work performed that is solely related to an individual domestic is excluded from the Lead State/Exam Facilitator's responsibility. For a discussion of specific responsibilities of the Lead State/Exam Facilitator, refer to the "Responsibilities of the Lead State" and the

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"Responsibilities of the Exam Facilitator" sections above. Additionally, Exhibit Z, Part Two – Section A and/or Exhibit Z, Part Two – Section B should be completed in this scenario.

2) Participating State in a fully coordinated group examination – To demonstrate adequate participation, the participating state should complete Exhibit Z, Part Two – Section C to assist in documenting compliance with the responsibilities outlined in the "Responsibilities of States Participating in a Fully Coordinated Exam" section above. Such documentation may be supplemented by a separate memo, if deemed necessary, to demonstrate compliance. In addition, the participating state assumes ownership of any state-specific procedures that are performed and is responsible for the quality of such work.

3) States not participating in a fully coordinated group examination – States in this category conducted a standalone examination separate from the fully coordinated group examination. States in this category are responsible for all work contained in the examination file. If a state is utilizing existing work but was not directly involved in the planning, oversight and review of the examination work, this state takes ownership of the project and is responsible for the overall quality of work performed in support of examination conclusions. This state should perform a review of the testing state's work program and conclusions to ensure the work being relied upon is sufficient to meet the needs of its examination. When determining the extent of review, the state utilizing the work of another state should consider its comfort and experience with the quality of work performed by that state. In addition, the accreditation status of other states may also be considered in determining the level of review to be performed by the relying state. Exhibit Z, Part Two – Section D should be completed in this scenario.

F. Examinations of Underwriting Pools, Syndicates and Associations

The examination of an underwriting pool, syndicate or association is the responsibility of the state in which the organization operates and, if it operates in more than one state, its examination should be coordinated by the Lead State, if possible.

The Lead State of an underwriting pool, syndicate or association is the one in which the organization's principal office is located. The Lead State shall set the time and supervise the conduct of the examinations and shall have discretion in inviting other states to participate in the examination and in defining their participation. The Lead State shall input the report on examination into FEETS and ensure each interested insurance department, each company that is a subscriber or member of the examined organization and the chair of the Financial Condition (E) Committee has access to a copy of the report. Each state in which an organization operates, however, shall have the right to examine the report, and any such state may commence its own examination if it deems necessary to do so, upon notice to the Lead State.

Each state is encouraged to recognize such reports on examination as official state documents, obviating the need for duplicative examinations, to establish procedures for reviewing these reports and to investigate and act upon any violations of law that they may disclose.

Where explicit regulatory authority does not exist over an underwriting pool, syndicate or association, each state in which it operates should negotiate with the organization itself, or with its subscribing members, to obtain an agreement that the organization will submit to the insurance department's examination and will pay examination fees and charges assessed against it.

G. Special E Committee Examinations

1. A special E Committee examination may be called by the NAIC Financial Condition (E) Committee if:
   a. Written reports from the non-domestic participating examiners indicate the examination conducted by the company's state of domicile is inadequate.
   b. The home state is reluctant to schedule an examination when IRIS results or other information indicate the need.
   c. A state in which a company is licensed requests a special E Committee examination.

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d. A report of examination has not been filed within 22 months of the "as-of" date for an exam on a multi-state insurer and a special E Committee examination is requested by the Examination Oversight (E) Task Force.

2. Special E Committee examinations are staffed with personnel selected from state insurance departments by the Financial Condition (E) Committee.

3. Special E Committee examination reports should be addressed directly to the Financial Condition (E) Committee.

H. Limited-Scope Examinations

Often, an insurance department may find it advisable to conduct financial examinations that are limited in scope. The department may utilize the Insurer Profile Summary or changes to the prioritization assessment in making the determination on whether these examinations should be conducted. While the reasons for such a situation are numerous, ordinarily such an examination will be convened in the following circumstances:

1. Unusual values identified through the Insurance Regulatory Information System (IRIS).

2. Internal department analysis of NAIC annual and/or quarterly financial statements identifies an issue.

3. Follow-up from a prior report of examination.

4. To address issues identified between coordinated group examinations.

5. Request from another insurance department regarding a known or indicated concern.

6. To provide information regarding a known or indicated concern that is necessary for the examination of another insurer.

7. Unusual complaint volume indicates a significant solvency issue.

8. Transactions disclosed under the NAIC *Insurance Holding Company System Regulatory Act* (#440) that indicate a concern or known issue.

9. Limited purpose examinations required by statute.

The NAIC encourages an efficient determination of a company's financial position, with special emphasis on troubled companies. Therefore, each financial condition examination is not conducted necessarily in exactly the same degree of detail or with the same emphasis on all aspects of a particular insurer's operations. Limited-scope examinations can be very effective in focusing examination resources quickly on those areas requiring immediate attention. Statutes of some states may require examinations at more frequent intervals. In addition, states have discretion to determine the appropriate audit scope, and the fact that an independent accountant is engaged by the company does not, by itself, preclude the necessity for a separate full-scope examination by the state. Although a state may typically participate on a coordinated group exam, it may identify a risk of a company that should be addressed in the interim period between group examinations. In this case, the state may find it beneficial to perform a limited-scope exam to address the risk while staying on the exam schedule of the coordinated group examination.

If the state's analysis of the company profile determines a particular insurer is the proper subject of a limited-scope, rather than full-scope examination, the notice of convening such an examination should clearly indicate its limited nature, the basis for convening a limited-scope exam, and an identification of the specific areas to be reviewed by the examiners in the Report of Examination. Should any state desire additional examination procedures, it should communicate such requests directly to the examining state.

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When a limited-scope exam is convened, the primary responsibility for determining the scope and depth of examination procedures rests with the examiner-in-charge who, presumably, has been closely connected with the preliminary determination of the examination focus. The examiner-in-charge must also coordinate the requests from other states for additional examination procedures. While those requests are to be honored, it is the ultimate responsibility of the examiner-in-charge to effectively manage the resources available, so that the initial reasons for a limited-scope examination and its objectives remain intact.

The examiner-in-charge should be able to accommodate reasonable specific requests without causing any disruption of the schedule. With the assistance of examiners from other states who take an active interest in planning and regularly evaluating the exam progress with the examiner-in-charge, the important regulatory goals of solvency, compliance and fairness should be achieved.

The unique nature of each limited-scope examination makes promulgation of a comprehensive reporting format or guideline herein of limited value. Nonetheless, such a report should describe at a minimum the limited objective of the examination noting the scope restriction in the Report of Examination, the overall scope of procedures applied, and the examiner's findings from performing those procedures. However, any state convening such an examination should distribute the examination report upon its completion, subject to any hearing or other due process requirements of the state initiating the exam.

The matter of prior notice will depend upon the circumstances under which the limited-scope exam is convened. However, it is NAIC policy that when a limited-scope examination is convened that would otherwise require notification to the NAIC and other regulators, such notice should be in accordance with the timing and distribution requirements of this Handbook, including calling the examination in FEETS and distributing the report of examination through the use of FEETS. If the convening authority determines such notification is not practical or advisable given the circumstances, notice shall be given contemporaneously with the examiner's date of entry.

I. Interim Work

1. Introduction

In addition to work performed in an interim period under a limited-scope examination, which is driven by a known issue, examiners may also encounter situations where it is advantageous to the regulatory process to perform work during the interim period that focuses on areas typically considered inherently risky, but for which no known issue has been identified. This is considered interim work and is structured in a way so as to be incorporated into the full-scope examination.

In situations when it is appropriate to investigate potential areas of increased risks or those typically considered inherently risky prior to the next scheduled full-scope examination, interim work may be performed and used to support the conclusions reached in the next scheduled full-scope examination. Interim work is typically driven by a plan constructed to address those higher risk areas on a staggered basis focusing on one or two risk areas in selected years between full-scope examination years. Examples may include reviewing the insurer's reinsurance strategy, reserving practices or related party agreements. Depending on the results of the interim work, the time spent for that risk during the fieldwork stage of the next full-scope examination may be reduced. Effective planning of this work can lead to more timely coverage of identified risk areas, as well as a more efficient and effective examination process for regulators and insurers. The following guidance provides a framework for performing interim work and incorporating it into the full-scope examination. Electing to perform interim work for selected insurers is a decision that should involve input from department management and other impacted states and is not required for use in risk-focused examinations.

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2. Conducting Interim Work

Once it is determined that interim work will be performed in support of the full-scope examination, there are numerous considerations and certain requirements that must be met when formulating an examination plan. The following guidance outlines the steps involved in performing each round of interim examination work:

Call the Examination

Subject to state laws and regulations, a formal exam call should be issued prior to the first round of interim work associated with a full-scope examination, thereby providing legal authority granted states to conduct an examination. In addition, for multi-state insurers, notification should be provided to all states in which the insurer is licensed (or registered for risk retention groups) or writing business based on Schedule T of the insurer's annual statement. This notification is in addition to, and therefore does not replace or alter the timing of, the full-scope examination call that must be made in FEETS. However, for companies that are part of a group with domestics in more than one state, it is expected that the Lead State will primarily assign interim work to its own staff, as opposed to delegating work to non-Lead States. Any non-lead state interested in participating in the interim work should contact the Lead State to communicate concerns and/or request participation in interim work activities. The FEETS notification should serve as a means to prompt non-lead states to contact the Lead State in this regard. Additionally, any non-lead state shall defer to the Lead State to initiate interim work activities for any company in the group. In the event a non-lead state identifies a benefit to conducting interim work when this work has not been initiated by the Lead State, the non-lead state should reach out to the Lead State prior to taking action.

In addition, it is recommended that the company be notified at least two months prior to the start of each round of interim work. When multiple rounds of interim work are identified through a pre-determined schedule, that schedule should be communicated to the company to the extent known at the time of the initial notification.

Understanding the Company

The information-gathering stage of any examination is important to fully understand the insurer and the potential risks. The examiner should, therefore, first obtain an updated copy of the Insurer Profile Summary (IPS) and meet with the analyst to discuss the potential risks of the insurer prior to planning and performing interim work. The annual analysis and the conclusions presented in the IPS will help prioritize and guide the timing of interim work. Since the annual analysis will be leveraged in preparation for interim work, the gathering of additional information by the examiner in planning interim work is not expected to include all elements typically reviewed during Phase 1 of a full-scope examination.

Many of the steps associated with planning a full-scope examination will not be deemed necessary in planning interim work and should only be performed as they pertain to the planned areas of focus. Examples include interviews with the full range of C-level individuals, review of fraud and identification of all key activities. Specific elements of planning that may vary during interim work from the format followed when performing a full-scope examination are as follows:

Consideration of Information Technology – A general IT review is not required prior to performing interim work, but may be performed as part of planned interim procedures to reach conclusions for the full-scope examination. However, since the results of the IT review can affect the reliance placed on IT systems in later phases of the examination, consideration of prior examination results and any significant changes that have occurred since the last IT review should be incorporated into planning for each interval of interim work. If widespread changes are identified, consider including an IT review in your interim procedure plans prior to proceeding with impacted procedures.

Understanding the Corporate Governance Structure – A review of corporate governance and enterprise risk management (ERM) is not required prior to performing interim work, but may be performed as part of planned

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interim procedures to reach conclusions for the full-scope examination. If significant changes are identified, consider including a review of corporate governance in your interim procedure plans.

Assessing the Adequacy of the Audit Function – Since the purpose of interim work is to allow examiners to interact with the company on a more regular basis in reviewing strategies and controls, utilization of audit work may be limited. An initial assessment of audit work is, therefore, unnecessary during interim procedures unless it is expected that this work will be of significant benefit in supplementing the work performed by the examiner. However, the examiner should consider meeting with the external/internal auditors to become aware of any significant issues such as control deficiencies or audit adjustments identified by the annual audit and respond accordingly.

Planning Materiality – The examiner's preliminary judgment of materiality should be calculated for each year in which interim work includes consideration of financial statement line items and could result in the identification of financial reporting misstatements. In the year the full-scope examination is conducted, materiality will again be calculated and compared to the interim planning materiality. If materiality calculated in the year of the full-scope examination is lower than at interim, the examiner should exercise judgment in determining if interim procedures should be updated to fully support the conclusions in the full-scope examination.

Prepare a Work Plan

Upon obtaining an understanding of the company and determining the focus of the interim procedures, a work plan should be prepared to document the preliminary information gathered and the planned procedures. The work plan should be documented in a memorandum and include, but is not limited to, the following elements:

Scope of Interim Work – Describe the scope of planned interim work by identifying the entities included in the examination and outlining the particular risk areas that will be encompassed by the review. Interim work may encompass areas typically associated with planning (such as corporate governance or IT), an entire key activity, and/or individual risks (current or prospective). This section of the memo should describe at a high level the extent of coverage expected to be obtained for the targeted area(s).

If the scope of interim procedures is focused on an area typically associated with full-scope examination planning, such as corporate governance assessment or IT review, the memo should indicate whether the interim procedures are intended to be a comprehensive review or a more narrowly targeted review (e.g., ERM or cybersecurity).

Finally, the description should clarify that the planned examination procedures are not all inclusive and, therefore, would not satisfy the full-scope examination requirement without additional work.

Summary of Internal/External Planning Meetings – Summarize the planning meeting that occurred between examiners and the department analyst, which should include review and discussion of the IPS as described above. Additional meetings with internal department personnel (e.g., chief examiner, financial analysts, actuaries, etc.) and external sources (e.g., company management, external auditors, etc.) should be summarized to the extent they are deemed necessary. Planning meetings should focus on potential risk areas at the insurer, proposed procedures for interim work and other issues relevant to the proposed work plan.

Consideration of Coordination Efforts – Document the coordination efforts, as well as the role of each state in performing interim work. The Lead State is expected to take primary responsibility for initiating, overseeing and/or delegating interim procedures that will be performed in support of the full-scope coordinated examination. The Lead State should notify other states with a domestic insurer in the group prior to the start of interim planning procedures to ensure concerns of all entities in the group are addressed as appropriate within the scope of the interim work. If a non-lead state determines there is a regulatory need to perform interim procedures in support of the full-scope examination on their domestic entity(ies) outside of the established coordination plan, they should first contact the Lead State to discuss the work plan.

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Use of Specialist – To fully address certain areas of focus during interim work, the use of a specialist may be required. The examination team should identify and document the need for and use of specialists, including a summary of the planned involvement of the specialist. Consideration may be given to utilizing the same specialist to update or roll-forward the interim work when the full-scope examination is conducted.

Exam Staffing and Budget – Identify and document the names and position titles of team members, including work assignments and budgeted hours for the examination. Include any specialists or consultants utilized.

Use of Key Activity Matrices/Exhibit V – Overarching Prospective Risk Assessment

For current and prospective risks, the key activity matrices and/or Exhibit V should be used to document interim work performed. For risks placed on Exhibit V, all columns should be completed in accordance with the guidance in the exhibit. This includes review of mitigation strategies, obtaining corroborating evidence and performing follow-up procedures. For risks placed on a key activity matrix, each phase should be evaluated and completed in accordance with the risk-focused approach. Interim work will typically place more emphasis on the review of controls/risk mitigation strategies because of the relative ease of rolling-forward and relying on this work in future periods, as opposed to the challenges in rolling-forward substantive tests of balances performed at a particular point in time. Because of the need to effectively roll-forward all interim work, if control deficiencies are identified, these concerns should be communicated to the company with an expectation they will be resolved prior to the full-scope examination. If the control deficiencies are not resolved prior to the full-scope examination or the examiner is unable to verify the resolution, the examiner may need to re-perform substantive procedures at the end of the full-scope examination period to ensure adequate coverage of the risk.

Reporting (Internal and External)

Interim work is performed in support of the full-scope examination and is intended to be incorporated into the final report of the full-scope examination. Therefore, no separate examination report is required to be filed in the interim period. If significant issues or concerns arise as a result of the interim work performed, communication of these items to the department, non-lead states, other regulators and the company should not be delayed.

Examiners should complete an Exhibit AA – Summary Review Memorandum (SRM), or a substantially similar document, to summarize the results of each round of interim work. Concerns should be summarized by branded risk classification and shared with the assigned analyst. Areas typically included on the SRM but not covered by the interim work, including branded risk classifications, can be noted as such without further explanation. The examiner should indicate if there are any proposed changes to the supervisory plan or prioritization of the insurer and explain the rationale for remaining consistent or suggesting changes. The examiner should coordinate with the analyst on the follow-up of any identified issues. This exchange will allow the analyst to use the information provided in the SRM to update the IPS at the conclusion of interim work. The updated IPS is the primary tool for sharing information among states and can be provided to other states upon request. The SRM may also be provided upon request to other states seeking additional details about the interim exam work conclusions.

Significant results and observations noted during the examination should also be communicated to the board and/or management in a timely manner. A management letter is considered an examination workpaper and may be used for this purpose at the conclusion of a round of interim work. Those states not utilizing the management letter should communicate comments to the board and/or management during the exit conference or other means deemed appropriate.

3. Utilizing Interim Work in the Full-Scope Examination

When conducting an examination in which interim work was performed in support of the full-scope examination conclusions, steps must be taken to properly incorporate the work and ensure it remains relevant.

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Roll-Forward of Interim Work

Identifying and assessing significant changes in a company's processes or procedures that occur between the performance of interim procedures and the full-scope examination procedures is necessary to ensure conclusions remain applicable. A high-level review of changes that may have a significant impact on examination conclusions can be accomplished through Phase 1 planning procedures. Common sources for this information include planning meetings, interviews and review of documents typically obtained in the planning process. For interim work performed on areas typically associated with planning (such as corporate governance or IT), the roll-forward should be clearly documented and include any significant changes (e.g., turnover of management and/or board members, organizational structure, etc.), the approach used to identify significant changes and the impact of such changes on the overall conclusions for the targeted area.

The examiner's conclusions regarding a high-level understanding of how identified changes may affect examination conclusions for all interim work—including areas typically associated with planning, an active key activity and/or individual risk (current or prospective)—should be documented in Exhibit I – Examination Planning Memorandum. The planning memo should also summarize interim procedures performed and the intended reliance on such procedures for the full-scope examination.

When completing a full-scope examination, the conclusions reached shall be based on work performed during the examination period. In instances when interim procedures rely on a simple assessment of changes rather than full testing procedures (typically in situations of control reliance), complete procedures that satisfy the expectations of the risk-focused approach must be performed at the end of the exam period. Alternatively, if the work at the end of the period relies on rolling forward interim work, then interim work should consist of procedures performed that satisfy the expectations of the risk-focused approach. Testing from a prior examination period cannot be used as the primary support for a full-scope examination.

Key Activity Matrices/Exhibit V – Overarching Prospective Risk Assessment

Interim work may be performed in response to a risk or series of risks that will be assessed on a key activity matrix or Exhibit V. When this occurs, the work performed at interim may address some or all of the risks identified for review in the full-scope examination for a particular key activity or on Exhibit V. For identified risks addressed at interim for a particular key activity or prospective risk, the examiner should determine whether any updates to the testwork or conclusions reached at interim are necessary. If control deficiencies were identified, the examiner should verify the deficiencies were appropriately resolved in order to fully rely on the conclusions reached at interim or perform substantive procedures at period end if issues are not resolved. Additional work may also need to be considered if there have been changes in the exposure, key processes, employees, etc. This conclusion should be clearly documented in the examination file along with the interim workpapers upon which reliance is placed and any additional testing performed to supplement interim work in light of changes.

In addition to the documentation requirements outlined above, if the examiner identifies other risks that need to be reviewed beyond those addressed in interim procedures, such risks should be added to the exam file and addressed through the full seven-phase examination process as a supplement to the interim work performed. Such work should be presented separately from interim work (i.e., separate matrix or tab) to make it clear when various risks were addressed during the examination and which risks were subject to roll-forward review. In every examination, strong consideration should be given to identifying and addressing additional overarching prospective risks on Exhibit V beyond those addressed at interim.

Critical Risk Categories

Exhibit VD – Critical Risk Categories is required to be completed for each full-scope examination, but the categories may be addressed through work performed at interim or at the conclusion of the full-scope examination. In all cases, the Exhibit must include references to where work addressing related risks is located in the full-scope examination file, and all interim work related to critical risks must be subject to adequate roll-forward review as discussed above.

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Examination Reports

The examination report is issued upon completion of a full-scope examination and may be supported by procedures performed at various points during the examination period. In order to accurately represent the information obtained to support examination conclusions, elements of the report may require modification if reliance is placed on interim work as follows.

Reference to Interim Work in Full-Scope Examination Report – When interim work is utilized in support of the full-scope examination conclusions, reference to such work should be made in the scope section of the examination report. Following is an excerpt from Section 2, Phase 7A.2.c demonstrating with the underlined sentence how this reference can be incorporated.

All accounts and activities of the company were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made by management and evaluating management's compliance with statutory accounting principles. As permitted by the *Financial Condition Examiners Handbook*, some of the work performed in support of the conclusions in this examination report was performed within the reporting period on an interim basis. The examination does not attest to the fair presentation of the financial statements included herein. If, during the course of the examination an adjustment is identified, the impact of such adjustment will be documented separately following the company's financial statements.

Impact of Findings/Exam Adjustments Identified in Interim – The content of the examination report should be consistent with guidance in Section 2, Phase 7, and should include significant findings of fact for issues identified during the interim period and the full-scope examination work. Findings identified as a result of interim work should be identified as such and include a brief discussion on whether items have been adequately resolved or remain a concern at the end of the examination period.

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II. EXAMINATION PERSONNEL

This section of the Handbook addresses the following subjects:

A. Examiner Definitions and Qualifications
B. Authority and Responsibility of the Examiner-In-Charge
C. Duties and Responsibilities of Non-Domestic Participating Examiners
D. Salary and Per Diem Guidelines

A. Examiner Definitions and Qualifications

Insurance Company Examiner

An Insurance Company Examiner shall meet and continue to meet the qualifications set forth below:

(a) An Insurance Company Examiner shall be: (i) an insurance department employee, or (ii) self-employed, exclusively or primarily as an Insurance Company Examiner, on a contract basis with an insurance department; and

(b) An Insurance Company Examiner shall be: certified by the Society of Financial Examiners (SOFE) as an Accredited Financial Examiner (AFE); or Certified Financial Examiner (CFE). An AFE or CFE must meet and continue to meet all conditions of SOFE necessary to be eligible to hold the title of AFE or CFE, including but not limited to SOFE's experience requirements, successful completion of required SOFE examinations, SOFE's continuing education requirements, compliance with SOFE's Code of Ethical Conduct, and payment of SOFE fees relating to maintenance of such continuing certification.

Automated Examination Specialist* (Information Technology (IT) Examiner)

*The position of Automated Examination Specialist is a synonym for IT Examiner and is not necessarily related to SOFE's AES designation.

An IT Examiner is an examiner who is responsible for coordinating, directing and implementing the automated portion of an examination and evaluating the controls of an insurer's information technology.

An IT Examiner shall meet and continue to meet the qualifications set forth below:

(a) An IT Examiner shall be: (i) an insurance department employee, or (ii) self-employed, exclusively or primarily as an IT Examiner, on a contract basis with an insurance department.

(b) An IT Examiner shall have sufficient knowledge, background and experience to perform the IT portion of a financial examination given the sophistication and complexity of the insurer's IT environment. This may include, but is not limited to, obtaining certifications such as SOFE's Automated Examination Specialist (AES) or the Certified Information Systems Auditor (CISA), sponsored by the Information Systems Audit and Control Association (ISACA).

Senior Insurance Examiner

A Senior Insurance Examiner shall meet and continue to meet the qualifications set forth below:

(a) A Senior Insurance Examiner shall be: (i) an insurance department employee, or (ii) self-employed, exclusively or primarily as an Insurance Company Examiner or Senior Insurance Examiner, on a contract basis with an insurance department; and

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(b) A Senior Insurance Examiner shall be: certified by the Society of Financial Examiners (SOFE) as a Certified Financial Examiner (CFE). A CFE must meet and continue to meet all conditions of SOFE necessary to be eligible to hold the title of CFE, including but not limited to SOFE's experience requirements, successful completion of required SOFE examinations, SOFE's continuing education requirements, compliance with SOFE's Code of Ethical Conduct, and payment of SOFE fees relating to maintenance of such continuing certification.

Insurance Examiner-In-Charge

An Insurance Examiner-In-Charge is an examiner who is responsible for the report, coordination and direction of the examination of a domestic insurer, including a non-domestic participating examiner from an accredited state, who is responsible for completing an affidavit of participation, on a non-accredited state's examination. (Note: Does not include other non-domestic participating examiners.) See part B below for qualifications.

Supervising or Administrative Examiner

A Supervising Examiner must be a CFE, have a minimum of 10 years experience examining insurance companies and supervise more than one examination of multi-state insurers concurrently.

B. Authority and Responsibility of the Examiner-in-Charge

A person shall only be eligible to be the examiner-in-charge of an examination of a multi-state insurer if such person holds the certification of Certified Financial Examiner (CFE) from the Society of Financial Examiners or be directly supervised by someone holding the CFE designation. The examiner-in-charge has the following authority and responsibilities:

1. Planning the examination

   a. Oversee the risk-focused surveillance process by identifying risks and the company's processes to assess those risks.
   b. Develop initial written plans.
   c. Update written plans periodically to reflect progress.
   d. Advise all other examiners of all current examination developments.
   e. Confer with all other examiners on all major examination problems on a current basis.
   f. Coordinate with specialists utilized in the examinations (e.g., IT examiners and independent actuaries).

2. Supervision of examiners, including non-domestic participating examiners

   a. Supervise the conduct of the examination.
   b. Allocate work assignments.
   c. Review each examiner's work plan and revise where necessary.
   d. Monitor progress against plans regularly and initiate necessary corrective action to ensure the examination is completed in a timely and professional manner.
   e. Ensure professional conduct of examiners.
   f. Review each examiner's workpapers to see that they support the examiner's conclusions and findings.
   g. Prepare and deliver performance reviews of domestic examination staff and non-domestic participating examiners on a timely basis.
   h. Monitor the hours worked vs. the budgeted hours.

3. Report to an appropriate level supervisor regarding a non-domestic participating examiner whose performance does not meet expectations.

4. Maintain liaison with company management

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a. Conferences or other communications with company officials, except regarding minor matters, should be made only with the full knowledge of all non-domestic participating examiners.
b. The hours during which an examination should be conducted shall, except where different hours are prescribed by the state department in charge of the examination, correspond as closely as possible to the working hours of the company being examined.

5. Provide for the security of company records and information

6. Prepare examination report

a. Develop report in consultation with all other examiners before completion of fieldwork.
b. If a disagreement among the examiners (including the examiner-in-charge) cannot be resolved (e.g., by the procedure established in Part X H. – Coordination and Distribution of the Examination Report of a Multi-State Insurer and the Resolution of Report Conflicts of this Handbook section), include in the report the comments of the dissenter(s) and indicate which are the majority and minority opinions. (If there is an even split of opinion, so indicate.)
c. The preparation of examination report should be developed in consultation with all other examiners. (The examiner-in-charge or domiciliary state insurance department shall not change or amend a final work copy of any examination report on a multi-state insurer without prior advice, consultation and approval of the non-domestic participating examiners.)

7. Maintain summary of actual hours spent on each examination activity

8. Conduct the examination in a manner consistent with the standards set out in Letter C. (below), as appropriate.

C. Duties and Responsibilities of Non-domestic Participating Examiners

A person shall only be eligible to represent a zone on an examination of a multi-state insurer if such person has been certified by the Society of Financial Examiners as an Accredited Financial Examiner (AFE) or a Certified Financial Examiner (CFE). The non-domestic participating examiner have the following authority and responsibilities:

1. Cooperate with the examiner-in-charge and other examiners in the conduct of the examination:

a. Assume responsibility to perform the duties assigned to examiner by the examiner-in-charge.
b. Take an active interest in the examination as a whole.
c. Inform the examiner-in-charge of examination developments on a current basis.

2. Make appropriate arrangements with examiner-in-charge for carrying out specific instructions given to the examiner and for obtaining specifically requested information.

3. Devote full time to examination duties and responsibilities.

4. Adopt the rules of conduct established for the examination team.

5. Observe professional standards of conduct free from any impropriety in fact and appearance, and avoid any situations or circumstances that may reasonably appear to influence independence, judgment or discretion.

6. Respect the confidentiality of information developed or received during the course of an examination.

7. In addition to performing duties assigned by the examiner-in-charge, perform such other work as the examiner deems necessary to obtain assurance that major solvency risk areas, specific concerns expressed by the zone he/she represents, and other concerns arising during the examination have been addressed in the examination. This objective can normally be met by reviewing work performed on key activities of the company. (Note that the non-domestic participating examiner should not duplicate the work of the examiner-in-charge.)

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8. In addition to performing duties assigned by the examiner-in-charge, review other work as the examiner deems necessary for a fair and complete examination.

9. Prepare dissenting opinions, if any, for inclusion in the examination report with respect to each issue the examiner deems significant and which is not reflected in the majority report.

10. Upon completion of the examination, the non-domestic participating examiner should proactively communicate the examination findings and conclusions to the other states within his/her zone.

11. All examiners should comply with the universal confidentiality agreements enforced in their respective state(s).

12. Typically, the non-domestic participating examiner should remain on the examination until the significant examination areas have been completed and all of the major examination issues have been addressed. However, this procedure may be varied for justifiable reasons. Signed signature sheets may be left with the examiner-in-charge if the non-domestic participating examiner leaves the engagement prior to having a copy of the rough draft of the report.

13. Any major difference arising during the course of an examination that is not resolved after thorough discussion with the examiner-in-charge and the participating examiners should be reported to the examiner's chief examiner and zone secretary by the examiner involved.

D. Salary and Per Diem Guidelines

Salary and per diem charges are to be computed beginning at the time of reporting for duty at the office of the company to be examined and terminating upon completion of the examination or the examiner's active participation therein and to include actual days for travel as certified by his or her commissioner.

1. Suggested Compensation:

   The proposed competitive salary schedule for all examiners is as follows:

Classification	Daily Rate
Insurance Company Examiner, AFE	$329.00
Automated Examination Specialist, AFE (no AES)	$403.00
Senior Insurance Examiner, CFE	$403.00
Automated Examination Specialist, AES or similar designation	$453.00
Automated Examination Specialist, CFE (no AES)	$453.00
Insurance Examiner In-Charge, CFE	$485.00
Supervising or Administrative Examiner	$515.00

2. Reimbursement:

   The NAIC has adopted the use of CONUS reimbursement rates in relation to per diem payments. The CONUS rates can be found at: *http://www.gsa.gov/portal/content/104877.*

   Examiners shall not be reimbursed for travel time or travel expenses not actually incurred in connection with an assignment.

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Air Travel – Only one day of travel time will be authorized.

Land Travel – Travel time is expected to be no more than 400 miles per day.

Actual mileage will be compensated at the rates set forth by CONUS.

3. Illness & Holidays

On days which examiners are absent due to sickness or any other cause, no salary charge should be made to the company, provided the company is open for the normal transaction of business. If the examiner is available for work on site or on any national holiday or any other day that the company has optionally closed for business, he or she shall be allowed salary and per diem allowances for that particular day.

Examiners shall not be reimbursed for dual living expenses while on branch office assignments.

4. Maximum Reimbursement

Effective January 1, 2000, the lodging CONUS rates adopted by the General Services Administrations (GSA) and distributed by the NAIC did not reflect the reimbursable room taxes for the U.S. and the U.S. territories. Under the GSA requirements, these taxes are separately reimbursable. This change was made by the GSA as a result of several lodging establishments setting their room rates in accordance with the maximum per diem amount and then adding lodging taxes to that amount. Per the GSA, the new method of having taxes excluded from the per diem amount will assure U.S. travelers that they will most likely be properly reimbursed for lodging costs. (Per diem rates for foreign countries continue to include the reimbursable lodging taxes.)

As an example, the city of Chicago, Illinois may have a maximum per diem amount for lodging of $155. Therefore, the actual reimbursable amount for lodging would be $155 plus the actual room taxes paid. If state and local lodging taxes equal 17.5% of the room rate, then the actual reimbursable amount would be $182.13 ($155 for lodging plus $27.13 for lodging taxes). The GSA currently does not have any restrictions on the reimbursable lodging taxes.

Lodging expenses should be supported with actual receipts. A meal allowance should be paid on a basis consistent with the CONUS rates. In lieu of the above, it is recommended that examiners working within a 50-mile radius of their official domicile receive a commuting allowance.

Necessary exceptions or clarifications to the preceding should be directed by the commissioner of the state employing the examiner consistent with the intent of this policy.

5. Official Domicile

It is recommended that examiners be authorized to return to the official domicile every other weekend. Expenses will be paid based upon the lesser of airfare or mileage. This reimbursement is made in lieu of the per diem allowance. It is understood that the travel will be done with a minimum amount of work time lost.

6. Insurance Department Examinations

All payments covering insurance department examinations shall be made directly to the home state of the examiner, if consistent with the laws and fiscal procedure of such state.

7. Statutory Provisions

The foregoing shall be subject to the statutory provisions in any state governing compensation and expenses of department examiners representing such state.

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III. GENERAL EXAMINATION CONSIDERATIONS

This section covers procedures and considerations that are important when conducting financial condition examinations. The discussion here is divided as follows:

A. General Information Technology Review
B. Materiality
C. Examination Sampling
D. Business Continuity
E. Using the Work of a Specialist
F. Outsourcing of Critical Functions
G. Use of Independent Contractors on Multi-State Examinations
H. Considerations for Insurers in Run-Off
I. Considerations for Potentially Troubled Insurance Companies
J. Comments and Grievance Procedures Regarding Compliance with Examination Standards

A. General Information Technology Review

The examination of information technology (IT) utilized by an insurer has become an increasingly important part of the examination process as companies have placed a greater reliance on IT systems to run their business. IT general controls (ITGCs) are policies and procedures that help ensure proper operation of computer systems, including controls over network operations, software acquisition and maintenance, and access security. ITGCs provide a foundation necessary to ensure the completeness, integrity and availability of IT systems and data and comprise the environment from which application controls are designed, implemented and operated. An effective IT general control environment can, therefore, provide examiners with greater assurance regarding the overall reliability of a company's IT systems and the reports generated from those systems. In addition, this allows the opportunity to test and rely on automated application controls during Phase 3 of the exam. As such, a formalized process to complete a general IT review has been developed to assist the IT examiner in completing this important section of the financial condition examination. In a risk-focused examination, steps 1–5 of the general IT review process should be performed prior to the completion of planning the overall financial condition examination. Step 6 of the IT review process should be performed in conjunction with the remaining portion of the overall examination. The following steps document the process to be followed in completing the general IT review:

1. Gather Necessary IT Planning Information

   The first step in performing a general IT review is to gather the information necessary to plan the IT review of the insurer. At this time, the examiner-in-charge (EIC) and the IT examiner should work together to request that the insurer complete the Information Technology Planning Questionnaire (ITPQ), included in Exhibit C – Part One, to assist in the planning process. In addition, other relevant information to obtain in planning the IT review might include prior examination workpapers, work on IT systems performed by internal/external auditors or consultants, and information maintained by the insurance department's financial analysts.

2. Review Information Gathered

   After the information for planning the IT review has been gathered, including the ITPQ, the IT examiner should review the information obtained to assist in planning and determining the scope of the general IT risks to be reviewed. Some factors to consider as part of this process include:

   - The complexity of the insurer's information systems and IT risk mitigation strategies;
     The extent to which reliance will be placed on those risk mitigation strategies in the financial examination;
   - The length of time the existing system has been in place and any significant changes to the system;
   - The types of subsystems being used and how data is shared among systems;
   - The hardware and software being used and whether the software was internally or externally developed;

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- The extent to which the insurer outsources its IT functions;
- Past issues the insurer may have had with its systems;
- Answers provided from the insurer via the ITPQ;
- Documentation available from other sources, including external and internal auditors;
- The insurer's participation in electronic business and electronic data interchange;
- The amount of reliance placed on the work of third parties;
- The type, volume, and external availability of sensitive information that is processed and/or stored by the company and;
- Changes to the company's controls and/or processes to ensure compliance with the General Data Protection Regulation (GDPR), if applicable, or other relevant data protection requirements.

The IT examiner should consider which risks included on the Evaluation of Controls in Information Technology (IT) Work Program (Exhibit C – Part Two) are applicable to the insurer under examination and determine if there are additional general IT risks that should be reviewed for this insurer. Additionally, based on the review of internal and external audit work, the IT examiner may determine that sufficient testing has been performed to fully address specific risks or areas of concern. In this case, the IT examiner may document in the IT planning memo their comfort with, and planned reliance on, the specific internal and/or external audit work included in the file. Additionally, the IT examiner need not include these specific risks or areas of concern in the IT work program.

3. Request Insurer Control Information and Complete IT Review Planning

After the initial planning information has been gathered and reviewed, the Evaluation of Controls in Information Technology (IT) Work Program (Exhibit C – Part Two) to be utilized in the review should be created. As part of this process, the IT examiner should customize the standard work program to include only the general IT risks that are of concern for the insurer under examination. In addition to providing a list of risks in the work program, the IT examiner may wish to provide a list of common controls that indicate how a typical insurer may mitigate these risks to assist the insurer in developing a response. Finally, the IT examiner may consider prompting the insurer to include information supporting the IT controls in place to mitigate risks by including an information request in the work program distributed to the insurer. The IT review team should coordinate with the appropriate staff at the insurer to request a response. The insurer's response should indicate their controls in place to mitigate the risks identified in the work program. The IT examiner should review the company responses, considering the adequacy of the controls identified, and request evidence to test the effectiveness of the insurer's mitigating controls. The IT examiner may consider some of the examination procedures listed in the Evaluation of Controls in Information Technology (IT) Work Program (Exhibit C – Part Two), and complete the planning of the IT review.

After the work program has been finalized, the IT examiner should document the plan to complete the IT review. The plan should document the staffing to be used to complete the review, the scope of work to be performed and a proposed budget to complete the review. The plan should be subject to the review and approval of the EIC and additional examination supervisors, as considered appropriate by the state. This plan may be documented through the use of an IT review planning memo, or other workpaper that documents the approval of the EIC.

4. Conduct IT Review Fieldwork

The IT examiner should schedule examination fieldwork, with the initial fieldwork to include conducting interviews of key IT staff. These interviews should serve as an opportunity to substantiate and clarify some of the information provided by the insurer in Exhibit C – Part Two. The IT examiner may also gain additional information relating to key activities, risks, and risk mitigation strategies for the financial examination. As such, the IT examiner may want to invite the examiner-in-charge and/or other financial examination staff to participate in the interview process. Some of the potential candidates for interview include the Chief Information Officer, Chief Technology Officer, Chief Security Officer, System Architect, Chief System Engineer, and any other individuals responsible for maintaining, updating and testing the insurer's business continuity and disaster

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recovery plans. Example agenda items for IT interviews, subject to the areas of expertise for the interviewee, include but are not limited to:

- IT Strategic Planning;
- IT Governance;
- Leadership development and succession planning;
- Organizational structure;
- Risk management;
- Development and maintenance of policies;
- Budgeting;
- Security;
- E-Business;
- Business continuity;
- Acquisitions and integration;
- Architecture, development and implementation of major programs;
- External environment, and
- Any other items necessary to evaluate the insurer's general IT controls.

After the IT review team has completed the interviews, the team should begin to test the general controls identified by the insurer. This work should be completed with the assistance of the insurer's IT staff and should utilize the existing work of others, if deemed appropriate. As noted in step 2 above, if the IT examiner has determined that reliance will be placed on all or some of the work performed by CPAs or the company's internal audit function (if deemed independent) to fully address a specific risk or area of concern, the IT examiner would not be required to include those specific risks or areas of concern on the work program. However, if the IT examiner determines that the work performed by the third party only partially addresses a risk, but additional work would be required to fully address that risk, the IT examiner should include the relevant third-party documentation in the file and map or link it to the respective risk in the work program.

After considering the utilization of existing work, testing of general IT controls and other procedures should be performed in order to gain an appropriate level of understanding of the insurer's IT environment and the effectiveness of general IT controls in place. As noted above, the IT examiner may consider performing examination procedures listed in the Evaluation of Controls in Information Technology (IT) Work Program (Exhibit C – Part Two) or any other procedures necessary to conclude upon the effectiveness of the company's general controls in mitigating the risks identified. All testing should be documented appropriately to ensure that the work may be referenced within the financial examination workpapers, as necessary.

5. Document Results of IT Review

At the conclusion of the IT review fieldwork (at or prior to the conclusion of planning of the financial examination process), the IT examiner should have a completed IT controls work program supported by documentation and testing as a deliverable. In addition, a summary of findings regarding the insurer's IT environment and general IT controls should be prepared at this time. The findings may be considered prospective in nature (i.e., recommendations to the company) or current in nature (which may have an impact on the financial exam). These findings should be documented through the use of an IT summary report (or similar document), which should include a description of recommendations to the company and/or how the findings may impact the examiner's reliance on general IT controls and approach to application control testing in Phase 3. The IT summary report may also include a summary of the insurer's IT operations, and detail on the IT review work performed. Based on the impact of the findings, the IT examiner should determine whether the IT general control environment is generally effective and would, therefore, indicate that IT risks have been sufficiently mitigated to allow for testing of application controls in Phase 3. If the IT general control environment is not deemed effective, the examiner would be required to perform additional testing in later phases of the exam before relying on system generated reports or controls in place at the insurer.

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Whether the IT general control environment is deemed effective ultimately depends on the IT examiner's professional judgment. Typically the IT general control environment would be considered effective unless the specific findings summarized in the IT summary memo would otherwise indicate. Often, even when issues are identified, the IT examiner may be able to determine that the finding is isolated to a specific system or point in time and, therefore, would not impact the overall reliability of the IT general control environment. In this case, the IT examiner should document in the IT summary memo which key activities or specific applications may be impacted by IT review findings and how.

In some instances, the overall IT general control environment may be deemed ineffective. In reaching this conclusion, the IT examiner should consider whether the findings outlined in the IT summary report:

- Are pervasive throughout the IT general control environment.
- Significantly impact the systems used in calculating and reporting financial results or the accuracy of information used in reaching major strategic decisions.
- Indicate deficiencies relating to management involvement and oversight of the IT strategy and direction.
- Are not alleviated by other mitigating factors.

The IT examiner is cautioned against defaulting to the conclusion that the overall IT general control environment is ineffective, as such a conclusion could have a significant impact on the approach taken by the financial examiner on the remainder of the examination. For instance, in Phase 3, the examiner would be required to test manual or compensating controls for an identified risk if application controls cannot be relied upon and, therefore, may not be able to reach strong controls reliance. If the controls in place to mitigate an identified risk are highly dependent on the company's computer systems, it may not be possible to rely on controls, and could require additional detail testing in Phase 5 to fully address the identified risk. Additionally, the examiner would be required to test the accuracy and completeness of system generated reports, prior to those reports being utilized in addressing the identified risk in Phase 5.

The IT review process outlined up to this point, along with the corresponding documentation of results, may be performed on each examination, regardless of insurer size. These documents should also be appropriately presented and discussed with the examiner-in-charge to help facilitate a general understanding of the IT systems in place at the insurer and the impact that any findings may have on the ongoing exam.

6. Assist on Financial Examination

Following the completion of the IT review of the examination, the IT examiners involved in the IT review should remain available to assist in the completion of the financial portion of the examination. Such assistance could include data mapping, ACL testing, clarification of work performed during the IT review, assistance in completing the examination report and recommendation letter, and additional assistance in testing IT application controls to mitigate risks identified by the financial examination team.

Although the identification and assessment of risk mitigation strategies is the responsibility of the examination team as a whole, the IT review staff may have additional insight and experience that may be beneficial in identifying and testing IT controls associated with particular insurer applications. The involvement of IT review staff in this area of the examination may be especially beneficial when examining companies with well documented internal controls that may allow the examination team to reduce substantive testing.

Cybersecurity Considerations

As the examiner reviews an insurer's operations, he or she may determine that the insurer has significant exposure to cybersecurity risks. The specific risk exposure for the insurer may vary based on volume, type of sensitive information (e.g. Social Security numbers, protected health information, personally identifiable health information, etc.) and the broad security environment in which the insurer is operating. The examiner should be mindful that the insurer is not required to use any particular IT security framework, nor are its IT security systems or controls required to include all of the components of any single or particular IT security framework or the examiner's work program. The examiner should

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broadly consider not only the volume and type of sensitive information obtained, maintained or transmitted by the insurer, but also the laws and regulations to which the insurer is subject, as well as the size and complexity of the insurer's operations and the nature and scope of its activities. All of these factors will influence the cybersecurity policies and systems and the IT security framework or frameworks that are appropriate for a particular insurer to effectively protect its sensitive information. As a result, responding to a particular insurer's risk will require judgment by the examiner in tailoring the use of existing Handbook guidance. In these situations, examination teams should review the insurer's risk mitigation strategies and/or controls that identify cybersecurity risks to protect against and detect cybersecurity incidents, and respond to and recover from cybersecurity incidents when they do occur.

When assessing the level of an insurer's cybersecurity controls/processes, the examiner should take into account the distinction between the roles of the insurer's board of directors and its senior management. The examiner should recognize that, while it is the role of the board to understand and oversee the insurer's cybersecurity policies, systems and controls, it is the role of its senior management to implement the insurer's cybersecurity policies and to ensure the performance and outcomes of the insurer's risk mitigation strategies and controls are appropriate. Strategies and controls should identify, protect against, and detect cybersecurity incidents, as well as allow the insurer to respond/recover from such incidents. Each of the primary information security functions are described below:

- Identify - The identification of cybersecurity risks is important in helping the organization understand the best way to deploy its limited resources. Internal risk assessment is crucial for organizations to understand constantly evolving risks. Participation in information networks, though not required, is likely to enhance understanding of risks. In a robust control environment, insurers devote resources to a risk assessment process that includes some amount of management/board involvement, appropriate to the distinct roles of the board and senior management, as well as a sufficient level of technical expertise to ensure that issues are well understood and responded to appropriately.

- Protect - Protection is an important element in the overall strategy for any risk and cybersecurity is no exception. A robust risk mitigation strategy may include a combination of strong policies, system and network access controls, and data security protection (e.g. data-at-rest, in use, in transit, and in storage are protected, etc.), as appropriate to the broad security environment in which the insurer is operating, including the volume and type of sensitive information obtained, maintained, or transmitted by the insurer, the security laws and regulations to which it is subject, its size and complexity, and the nature and scope of its activities. When applicable, controls should directly address risks presented by third party access to the insurer's network, systems and data (including access by vendors, agents, brokers, third-party administrators [TPAs] and managing general agents [MGAs]). Training is also an important part of the insurer's response to cybersecurity risks as many incidents occur due to improper execution of controls rather than the lack of controls. Control effectiveness is limited if employees are not provided adequate training to understand the objectives and importance of their assigned responsibilities.

- Detect - Insurers should also have a strong set of detective controls that enable timely identification and mitigation of threats in the organization. These may include anti-virus and anti-malware software as well as network monitoring and intrusion detection related processes and controls. Organizations may perform vulnerability scans and penetration tests to ensure that weaknesses in the protective/detective controls are identified and addressed.

- Respond and Recover - A review of the insurer's incident response plan is an important consideration in the overall assessment of cybersecurity at an insurer. The response to a cybersecurity incident may leverage concepts from the insurer's broader disaster recovery plan, but may also require unique considerations since recovering from a cybersecurity incident requires a different response than recovering from an environmental incident (e.g. fire, earthquake, tornado, etc.). The examiner should note, however, that network threats and incidents are not rare events like environmental incidents. It is also important that people with assigned responsibilities within the disaster recovery plan have the necessary background/training to perform the assigned duties. Insurers should include in their plan who they are required to contact in the event of a security incident (regulators, affected parties, etc.) and how public relations will be managed to limit the impact of the incident on the organization's reputation. Importantly, response plans should be tested to ensure that the organization is ready to deploy the plan in the event of an actual incident.

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When significant incidents do occur, it is important that the insurer performs a thorough post-remediation analysis and restores services that were affected as a result of the incident in accordance with the response plan. Examination teams may consider reviewing incident reports to consider how the organization has learned and adapted when security protocols are breached.

Depending on the insurer's operations, there may be unique risks that the examiner identifies for further review. For instance, some insurers may leverage controls at service providers to provide assurance over cybersecurity risks. While this may be appropriate, insurers should be able to confirm that the service provider has appropriate risk mitigations strategies and controls in place and that appropriate protections are built into their service agreements (e.g. indemnification clauses, right to audit, technology errors and omissions insurance coverage, etc.) to address the risks presented to the insurer.

Although uncommon, if the examiner determines that the insurer has significant exposure to cybersecurity risk, the examiner may consider incorporating the use of a cybersecurity expert to assist in performing cybersecurity procedures. The specific risk exposure assessment for the insurer should be based on the IT examiner's judgment and may consider the insurer's line of business, the size and complexity of operations, known cybersecurity incidents; risks presented by third-party access to the insurer's network systems and data, recent acquisitions, concerns about the controls in place to protect against, detect, respond and recover from cybersecurity incidents, or any other significant risk factors related to cybersecurity. Note that the decision to use additional expertise to address cybersecurity concerns should be based on the accumulation of circumstances and not necessarily due to any one situation discussed above.

The following insights may assist regulators and/or cybersecurity experts as they assess the strength of the insurer's security program and therefore the risk that cybersecurity events present to the insurer. These insights are for informational purposes and are not intended to be requirements for insurers. Companies may be assessed by their individual risk profile and the organization's risk strategy.

Events, Incidents and Breaches

As regulators engage insurers in discussion regarding past cybersecurity events, it may be useful to understand the difference between various types of events. A "cybersecurity event" can be defined as an event resulting in unauthorized access to, disruption or misuse of an information system or information stored on such an information system. Insurance companies may also use terms such as incidents and breaches or may distinguish between successful and unsuccessful events as they discuss their cybersecurity program. Regardless, regulators should gain an understanding of how the insurer defines its events and incidents. Insurers should consider both unsuccessful cybersecurity events and successful cybersecurity events (incidents), as appropriate. For instance, while an unsuccessful event may only access the company's network without accessing sensitive information, it may still represent an event that the insurer should consider, correlate with other activity, and learn from to ensure security practices are enhanced, as appropriate. Timely, effective incident response is extremely critical in minimizing the impact of a cybersecurity incident.

Integration of Cybersecurity Risk into Enterprise Risk Management

As noted before, an insurer's board and/or senior management often play a significant role overseeing a cybersecurity program. As an insurer's cybersecurity risk increases, examination teams may want to scrutinize the integration of cybersecurity risk into the insurer's Enterprise Risk Management. This may include consideration of the level of information provided to the board and/or senior management and the appropriateness of the insurer's risk identification and assessment process. It may be appropriate for board and/or senior management to receive summary level information, but there should be a designated person with cybersecurity expertise that is responsible for developing the insurer's response to cybersecurity risks. This person should be deemed the insurer's cybersecurity risk owner and should receive information that is tailored to the insurer's specific cyber risk exposures. For instance, use of third-party service providers, integration of acquired companies, legacy systems, etc. may all represent unique exposures that require specific consideration as mitigation strategies are developed.

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Information Security Program

Note: The guidance that follows should only be used in states that have enacted the NAIC *Insurance Data Security Model Law* (#668). Moreover, in performing work during an exam in relation to the Model #668, it is important the examiners first obtain an understanding and leverage the work performed by other units in the department, including, but not limited to, market conduct-related work.

Specific requirements related to an insurance company's information security program are included in Model #668. States that have passed the law may have an enhanced ability to encourage remediation of control issues in relation to issues identified during the exam. To the extent a state has adopted Model #668 and it is in effect at the time of the examination, examiners may consider tailoring the IT review to include consideration of the items below. As evidenced below, implementation of each control identified for consideration shall be done based on the insurer's individual risk assessment:

Section 4-C of Model #668 details the requirements for performing a risk assessment. As part of a risk assessment, the licensee shall perform the following:

1. Designate one or more employees, an affiliate or an outside vendor designated to act on behalf of the licensee who is responsible for the Information Security Program.

2. Identify reasonably foreseeable internal or external threats that could result in unauthorized access, transmission, disclosure, misuse, alteration or destruction of nonpublic information, including the security of information systems and nonpublic information that are accessible to, or held by, third-party service providers.

3. Assess the likelihood and potential damage of these threats, taking into consideration the sensitivity of the nonpublic information.

4. Assess the sufficiency of policies, procedures, information systems and other safeguards in place to manage these threats, including consideration of threats in each relevant area of the licensee's operations, including:

    a. Employee training and management.

    b. Information systems, including network and software design, as well as information classification, governance, processing, storage, transmission and disposal.

    c. Detecting, preventing and responding to attacks, intrusions or other systems failures.

5. Implement information safeguards to manage the threats identified in its ongoing assessment, and no less than annually, assess the effectiveness of the safeguards' key controls, systems and procedures.

Based on this risk assessment, Section 4-D requires the licensee to execute the following:

1. Design its Information Security Program to mitigate the identified risks, commensurate with the size and complexity of the licensee's activities, including its use of third-party service providers, and the sensitivity of the nonpublic information used by the licensee or in the licensee's possession, custody or control.

2. Determine which security measures listed below are appropriate, and implement such security measures.

    a. Place access controls on information systems, including controls to authenticate and permit access only to authorized individuals to protect against the unauthorized acquisition of nonpublic information.

    b. Identify and manage the data, personnel, devices, systems and facilities that enable the organization to achieve business purposes in accordance with their relative importance to business objectives and the organization's risk strategy.

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c. Restrict access at physical locations containing nonpublic information only to authorized individuals.

d. Protect by encryption or other appropriate means all nonpublic information while being transmitted over an external network and all nonpublic information stored on a laptop computer or other portable computing or storage device or media.

e. Adopt secure development practices for in-house developed applications utilized by the licensee and procedures for evaluating, assessing or testing the security of externally developed applications utilized by the licensee.

f. Modify the information system in accordance with the licensee's Information Security Program.

g. Utilize effective controls, which may include multifactor authentication procedures for any individual accessing nonpublic information.

h. Regularly test and monitor systems and procedures to detect actual and attempted attacks on, or intrusions into, information systems.

i. Include audit trails within the Information Security Program designed to detect and respond to cybersecurity events and designed to reconstruct material financial transactions sufficient to support normal operations and obligations of the licensee.

j. Implement measures to protect against destruction, loss or damage of nonpublic information due to environmental hazards, such as fire and water damage or other catastrophes or technological failures.

k. Develop, implement and maintain procedures for the secure disposal of nonpublic information in any format.

3. Include cybersecurity risks in the licensee's ERM process.

4. Stay informed regarding emerging threats or vulnerabilities, and utilize reasonable security measures when sharing information relative to the character of the sharing and the type of information shared.

5. Provide its personnel with cybersecurity awareness training that is updated as necessary to reflect risks identified by the licensee in the risk assessment.

Review section 3 of the Model #668 for legal definitions of relevant and commonly used terms. For purposes of the exam process, licensees include, but are not limited to, insurance companies. Model #668 also covers the topics of board of directors oversight, third-party service providers, program adjustments, incident response plan, and the annual certification to the commissioner of the domiciliary state. Review Model #668 language for further insights on the topics above.

Evaluating Employee Training / Security Awareness Programs

Employees often represent the front line of any strong security program. However, without proper training, employees may also represent vulnerability in the company's defense program. Therefore, strong security awareness training can help in mitigating the risk presented by phishing e-mails and other social engineering attacks. Strong security awareness training may be characterized by:

- Use of real world examples to help users be able to identify phishing e-mails;
- Use of phishing emails sent to the user community by the insurers internal security specialists or security vendor to measure effectiveness of user training;

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- A clear protocol that provides employees help in identifying and reporting phishing e-mails; and
- Elements of a training that are tailored to the employee's specific roles, responsibilities, and access rights.

Since cybersecurity threats are constantly evolving, it is important to have a strong and up-to-date training regimen. Additionally, in a strong cybersecurity program trainings should be performed on a consistent and periodic (i.e. annually) basis to ensure the information reaching the employees is commensurate with the modern-day threats facing the company. As regulators evaluate the appropriateness of the program, they should consider whether the training is mandatory for all employees and whether it includes procedures and instructions for employees to follow in the event that an employee has a good faith, fact-based belief that a breach or cybersecurity event may have occurred.

Vulnerability Management

In the most robust information security programs, companies understand that not all vulnerabilities can be eliminated, typically due to business needs or time and resources. However, companies should have an understanding and should inventory their identified vulnerabilities as well as have a plan to ensure vulnerabilities that can't be eliminated are mitigated as much as possible. For instance, if the insurer is unable to confirm that a third-party service provider is able to secure their own access to the company's information system, the company should ensure they monitor the service provider's access to determine if improper activity occurs on the company's network. As many vulnerabilities originate with a company's patching practice, it is important that regulators obtain an understanding of the company's patch management. Research suggests that in any given year, the majority of breaches have a root in a Common Vulnerability and Exposure (CVE) that often has been known and identified for several years. An insurer should maintain a strong practice of patch management, or at least a practice of understanding and mitigating existing vulnerabilities as an important part of a robust security program.

Company Acquisitions

Finally, in situations where a company has recently acquired/integrated another company, the IT examiner should also pay special attention to the procedures performed in integrating company systems. This is often when companies are most vulnerable to cybersecurity threats as controls are often in flux and mistakes in integration may create vulnerabilities that are not easily identified or remedied.

Exhibit C, Part Two (Instruction Note 3) includes specific mention of risk statements and sections of the exhibit that can be applied to ensure the examination has an appropriate response to identified cybersecurity risks.

Note that the findings identified through the review of the company's cybersecurity control environment should be communicated to the financial examiner via the IT Summary Memo.

Customization for Small Companies

When conducting an IT review of a small company or a company with a non-complex IT environment, it is acceptable to limit the extent of testing procedures performed. However, the examination must adhere to the six-step process outlined above. This includes obtaining the ITPQ responses from the insurer, completing a basic work program, and preparing a summary memo concluding on the results of the IT review and its impact on the rest of the examination.

The most significant area to be customized for small insurers is the IT work program. Regardless of size or complexity, some level of testing is required to be performed to verify the basic effectiveness of the insurer's IT environment; however, the presentation of such work may vary. It is recommended that IT examiners perform some level of review for IT general controls in place within each domain of the COBiT Framework. This may be shown using a customized version of Exhibit C – Part Two, where a limited number of controls applicable to the insurer are populated and reviewed. In limited circumstances, as described below, IT examiners may bypass the utilization of Exhibit C – Part Two:

1. If the CPAs or the company's internal audit function (if deemed independent) have performed a review of ITGCs that sufficiently cover risks within each of the COBiT domains, the IT examiner may rely on such work without

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mapping or linking the work to a separate work program. However, the IT examiner must document their comfort with and planned reliance on the work performed.

2. When the IT environment is simplistic and the insurer utilizes purchased software programs from well-known vendors, IT examiners may choose to summarize, in memo format, the procedures performed for each domain of the COBiT Framework. However, before determining that it is appropriate to bypass the utilization of Exhibit C, IT examiners should consider whether the company has made significant modifications to the software being used, as modifications may impact the software's reliability. In situations where significant modifications have been made and continue to be made, IT examiners should utilize Exhibit C – Part Two to document a consideration of risks relating to change management.

B. Materiality

The examiners should consider materiality before planning and conducting examination procedures and when evaluating the results of those procedures. Materiality is defined as the dollar amount above which the examiner's perspective of the company's financial position will be influenced. It is determined at two levels during the initial planning stage: (1) an overall level as it relates to the annual statement taken as a whole; and (2) an individual balance (annual statement line item) level.

Considering Planning Materiality

Planning Materiality (PM) is the examiner's preliminary judgment of materiality made during initial planning. It is used in developing the overall scope of the examination procedures.

At the conclusion of the examination, the examiner evaluates whether the total effect of misstatements identified is material to the annual statement. Thus, it is necessary for the examiner to develop the scope of the procedures with a materiality consideration in mind. PM is used for that purpose. The amount considered material at the end of the examination may differ from PM since it is not ordinarily possible to anticipate all the circumstances that may ultimately influence the examiner's judgment about materiality used in evaluating the overall effect of misstatements on the annual statement. If the examiner determines that a significantly lower level of materiality is appropriate in evaluating the overall effect of examination differences, the examiner should reconsider the sufficiency of examination procedures.

The estimate of PM requires professional judgment, based on the examiner's understanding of the company's operations. The examiner needs to consider the (1) nature of the business, (2) operating results (e.g., stable earnings, consistently near break-even, volatile results), and (3) financial position. Consideration should also be given to how close the company's surplus is to levels that would trigger regulatory action.

Setting Materiality Levels

Some of the factors that should be considered in determining PM are discussed below, along with examples of some measures that might be used. These are not the only measures or percentages that may be appropriate based on professional judgment in particular circumstances. If a combination of measures is considered appropriate, the examiner should identify a range from which PM can be derived.

a. PM Based on Capital and Surplus Levels – Typically, fair presentation of capital and surplus levels is of primary importance in an examination. Generally, an appropriate starting point in computing PM is 1 percent to 5 percent of capital & surplus. What percentage of surplus to use depends on the circumstances of the examination. For example, if a company's capital and surplus declines toward minimum levels, the percentage used probably would be at the lower end of the range. Alternatively, for a strong, well-capitalized insurer with no apparent concerns, the percentage likely would be at the high end.

b. PM Based on Operating Results – Another important financial measure is operating results, often the gain from operations. An appropriate starting point in computing PM is 5 percent of the pretax gain from operations. Whether to use current year income or an average of previous years' income is a judgmental decision based on

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current economic conditions and earnings trends. In many situations, it will be appropriate to challenge the reasonableness of the different methods by computing income several ways.

The examiner should also consider the effective tax rate in setting PM. In some situations, the effective tax rate differs from the statutory rate due to a large capital gain, high level of tax credits, or nontaxable income. The starting point for PM assumes that a 5 percent change in pretax income will cause a 5 percent change in taxes and result in a 5 percent change in net income. Accordingly, PM may be a different amount in situations where the effective tax rate is significantly different from the statutory tax rate.

If the company operates at or near break-even or fluctuates between gain and loss from operations from year to year, pretax income may not be the most appropriate basis for computing PM. Also, because statutory accounting requires certain items to be reflected directly in surplus, statutory operating results may not be a good indicator of materiality. Premium volume or total revenue measures may be more appropriate. Again, it may be preferable to use more than one measure to identify a range from which PM can be derived.

c. PM Based on Financial Position – Another measure to consider in determining PM may be one-half of 1 percent of total assets. As gains from operations diminish and become minimal, their usefulness as a point of reference for computing PM also diminishes. In those situations, a smaller percentage of total assets (e.g., one-fourth of 1 percent) may be the most appropriate base.

d. Other Considerations – The general guidelines discussed above should apply to most examinations. However, in special situations the examiner may need to consider additional factors. In all cases, the estimate of PM requires professional judgment and consideration of a variety of factors – as no set of general guidelines can be all encompassing.

Documenting PM

The examiner should document in the Examination Planning Memorandum the reasons underlying the determination of PM and the amount established as PM.

Tolerable Error

Tolerable Error (TE) is the materiality for a particular account balance (annual statement line item) affected by a specific examination objective. It is the amount of monetary error that can exist in a specific account balance without causing the financial statements as a whole to be materially misstated when added to errors in other account balances.

Setting TE – When examining an account balance based on a specified level of materiality, it is possible that some amount of error below that level is present even if no errors are observed. As a result, if PM is used as the materiality level for specific examination tests, no margin is left for the aggregate effect of undetected errors. Thus, it is logical that the amount of TE set for each annual statement line item should be less than PM.

a. TE is a planning concept used to determine the amount of error that the examiner's testing is designed to detect. When the results of such tests detect an amount of error approaching or exceeding TE in that account, the examiner should evaluate the cause of the error and consider performing additional procedures to refine the estimate of acceptable error.

TE is related to the preliminary estimate of materiality in such a way that, when combined for the entire examination plan, it does not exceed PM. In other words, TE should be set for each account so the probability is remote that the total of undetected errors, detected errors, and judgmental differences from all accounts will exceed PM.

There are various statistical approaches to setting TE. These approaches result in TEs for various accounts that when simply added together exceed PM. However, when aggregated according to statistical formulas, those individual TEs result in an overall level of materiality that approximates PM. In other words, not all errors will

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move in the same direction. Therefore, the TE assigned to all accounts need not be so low that the sum of all TEs is less than PM. The appropriate level for setting TE will vary by examination. However, as a general guideline, TE can be set at fifty percent (50%) of PM for each particular annual statement line item.

b. Considerations in Changing TE from 50% – There are some typical situations where it is appropriate to set TE at other than 50% of PM. In considering these situations, the examiner should be aware of the implied judgment made when adjusting TE. As TE is increased, the examiner is implying that more risk can be accepted in the related account. This implication follows from the inverse relationship between TE and the extent of the examination procedures (the higher the TE, the smaller the sample size or, conversely, the lower the TE, the larger the sample size).

A higher TE also may be appropriate to use when the test's purpose is to detect errors that would result in balance sheet reclassifications (e.g., misclassification of investments or policyholder deposits).

The examiner may wish to increase the nature or extent of the examination procedures in initial examinations or in examining the recently acquired operations of a company. Reducing TE in these situations is appropriate because the examiner would not have any experience on which to base expectations of errors.

Passed Adjusting Journal Entry (PAJE) Scope

During the course of the examination, the examiner may encounter errors that do not require adjustment in the report of examination. These errors must be accumulated using Exhibit BB – Summary of Unadjusted Errors in order to determine whether the errors are material in aggregate and an adjustment should be made. Some errors which are clearly immaterial should not be included within this summary. In order to determine a minimum dollar amount under which errors should be excluded, the examiner should calculate the passed adjusting journal entry (PAJE) scope.

Setting PAJE Scope

As a general guideline, the PAJE scope can be set at 20% of TE. When the examiner encounters errors that are below this amount, they should be excluded from the Summary of Unadjusted Errors. For example, if the PAJE scope is set at $50,000 and the examiner notes a $75,000 error and a $30,000 error, the $75,000 error should be included on the Summary of Unadjusted Errors, and the $30,000 error, which is below the PAJE scope, does not need to be included.

C. Examination Sampling

Exam sampling is defined as the application of examination procedures to less than 100% of the items comprising an account balance or class of transactions for the purpose of evaluating some characteristic of the balance or class. In Phases 3 and 5 of the risk-focused examination process, sampling is frequently used to obtain examination evidence by testing controls, attributes, and account balances. Applying proper examination sampling procedures will allow the examiner to improve efficiency and effectiveness of his or her examination.

Examiners take a risk-focused approach to evaluate the overall solvency of a company but are not required to opine on the financial statement dollar balances. Therefore, this guidance focuses on both the testing of controls in Phase 3 and the testing of details, primarily attributes, in Phase 5. The sampling approach outlined herein allows an examiner to gain comfort in key activity areas but may not always produce a statistically valid sample for purposes of projecting errors across a population or proposing exam adjustments. In instances where more precision in sample selection is necessary or this guidance is deemed too general, examiners should exercise professional judgment in utilizing other resources to direct the use of sampling techniques such as AICPA sampling guidance or electronic sampling tools (e.g. ACL, IDEA, TeamMate Analytics, etc.). However, in these instances, examiners are expected to provide a description of the tool or guidance and the examiner's rationale for why using the tool or guidance is appropriate. The rationale should include a brief explanation of how the sample size was generated and justifications for any instances where the tool or guidance used contradicts concepts set forth by this Handbook.

Sampling worksheets have been developed to assist the examiner in determining, documenting, and concluding on sample selections. These worksheets can be found in *Exhibit O – Examination Sampling Worksheets* in Section 4 of this Handbook.

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The remainder of this section is divided as follows:

a. Determining Reliance on Audit Procedures
b. Selection of Testing Methodology
c. Sampling for Testing of Controls
d. Non-Statistical Sampling
e. Attribute Sampling

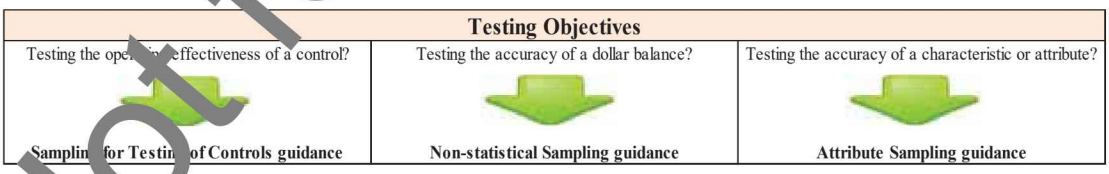
a. Determining Reliance on Audit Procedures

Audit workpapers can be used extensively to enhance the efficiency of an exam. The Phase 1 guidance in Section 2 of the Handbook assists examiners in developing an understanding of the company and offers guidance for determining whether the work of auditors can be used to reduce the review of financial reporting risks. If the audit function is deemed effective, it may be appropriate to eliminate certain low to moderate financial reporting risks addressed by the auditor from a detailed review through the examination process. In these situations, it would not be necessary for the exam team to document a detailed review of sampling techniques utilized by the auditors to test these risks. However, if the examiner determines that specific financial reporting risks tested by the auditor are significant (moderate to high risks) or will be used to address a relevant critical risk category, the examiner should subject these risks to the full examination process by placing them on a key activity matrix for review. In reviewing and testing these risks on the risk matrix, the examiner may still choose to place reliance on testwork and sampling procedures conducted by the auditor, but such work would be subject to detailed review and documentation in the exam file in Phase 3 or 5.

In reviewing audit workpapers for use in Phase 3 or 5, the examiner should ensure that the audit testing objectives align with the testing objectives established by the examiner. The examiner should also consider the auditor's intended level of reliance when determining the sufficiency of the sample size. If the examiner intends to place the same amount or a lower level of reliance on a test than was placed by the auditor, the sampling procedures employed by the auditor may be deemed sufficient if they meet the examiner's expectations and are adequately documented. However, if the examiner intends to place more reliance on a test procedure than was placed by the auditor, additional sample selections or alternate procedures may be required to provide sufficient supporting evidence. In these situations, the sampling guidance provided below may be used to assist in leveraging audit work on a key activity matrix level and/or determining the amount of additional sample selections needed to obtain sufficient exam evidence.

b. Selection of Testing Methodology

The following graphic may be used to assist examiners in determining which sampling methodology to follow based on the objectives of their testing.



In some instances, it may be appropriate or more efficient for an examiner to perform dual-purpose testing. Dual-purpose testing occurs when an examiner chooses to use the same sampling selections for both a Phase 3 control test and a related Phase 5 test. When dual-purpose tests are performed, the examiner should clearly distinguish which elements of the test relate to Phase 3 and which procedures relate to Phase 5 within the exam workpaper documentation. Although the selections are the same, the results of the Phase 3 control testing still must be incorporated into the Phase 5 testing. For example, if an examiner determines that 40 selections is an appropriate Phase 3 sample size and the appropriate sample size for the related detail test is 55 selections (assuming related controls will be strong), the examiner should select a sample of 55 items and perform Phase 3 control testing on

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40 of the 55 items. If there were no issues identified in the Phase 3 control test, the examiner should then perform their detail test as planned on all 55 selections. If issues were noted during the Phase 3 control test, the examiner should consider increasing the Phase 5 sample size and/or alternative procedures.

c. Sampling for Testing of Controls

In Phase 3, when sampling is considered appropriate for control testing, the examiner must determine the most efficient and effective way to perform tests of controls. The examiner should first identify the control being tested and the objective of the test. The most common control testing objective is to determine if the control is functioning properly and as designed throughout the testing period.

Automated controls consist of control processes performed by IT systems, and these differ from manual controls by generally eliminating the potential for human error (beyond overriding). If the examiner has determined that an automated control will consistently function in the exact same manner and IT general controls were deemed to be effective (as documented in the IT Summary Memo), the examiner may be able to perform testing by observing one instance of the control. Controls can vary by computer system or line of business, so examiners should test at least one occurrence of a control for each unique distinction. Common examples of where this treatment is appropriate are application controls that display an error message if duplicate information is entered or application controls that require an authorized person to approve a transaction before the transaction is processed.

The examiner should be cognizant of variables that may affect the examiner's testing approach and control reliance, including whether the system is subject to changes or revisions and whether management has the ability to override the system. Inappropriate management override or system changes made on more than an occasional or inconsistent basis may result in the automated control not performing as designed; therefore, it would be inappropriate for the examiner to decrease the sample size to less than the calculated number of items. When reduced sample sizes are not appropriate, the following guidance should be utilized:

1) Determine the control being tested. The examiner should gain an understanding and document the design of the internal control the company has in place. This information is typically obtained through company control documentation, auditor control documentation, interviews, and/or walkthroughs with company personnel.

2) Describe the objective of the test. The objective of a test of controls is to provide the examiner with evidence about whether controls are designed properly and operating effectively. For example, to determine whether investment purchases have been authorized, the examiner could examine investment committee minutes or payment vouchers to determine if the authorized company personnel signed the payment voucher before processing.

3) Define the population and an individual sampling unit. The definition of the population should describe all possible items that will be included in the selection process. The examiner should also identify and document the source that the sample will be selected from, including the report name. A sampling unit should describe the type of item that is available for selection and will be subjected to testing.

4) Define the period covered by the test.

5) Describe how completeness of the population was considered. The examiner should determine that the population contains all appropriate items available to select in the sample.

Scheduled or cyclical controls are executed by the company on a routine basis. For example, bank reconciliations are generally completed by the company on a monthly basis and therefore performed 12 times per year. It is important to note that controls performed on a cyclical basis do not automatically qualify as "automated controls". For a control to be automated, it must be performed by a computer system identically each time. Other controls are performed as often as a transaction or event occurs. For example, controls over a company's collections process may be triggered whenever cash or cash equivalents are received. In general, the examiner will perform the same testing process for both cyclical and transaction based controls, although the number of test selections

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will vary based upon the number of control occurrences. The examiner should determine the number of occurrences that took place during the defined testing period and use this number to proceed with sample selection and testing.

6) Define a deviation (error). A deviation or error in a test of controls is a departure from the sufficient performance of a control. A deviation could also be defined as a selection for which the company is unable to provide sufficient evidence of proper control performance. If a deviation or error is discovered, the examiner should ask the company to provide an explanation and evaluate its appropriateness. A deviation or error that cannot be appropriately explained by the company is considered an exception.

7) Determine the sample size. The examiner may utilize the table provided below to determine an appropriate sample size. For example, controls that occur monthly (12 times per year) should have a sample size between three and five items. If any deviations are found that cannot be explained as isolated incidences, the final assessed level of risk management should be weak. To assist the examiner in documenting sampling for controls, the test of controls worksheet (Part One of Exhibit O) may be utilized. Examiners should review the chart below to assist in determining sample sizes and use professional judgment to choose the most appropriate sample size based on the number of occurrences during the sampling period.

Control Frequency	Number of Control Occurrences in the Sampling Period	Sample Size
Annual	1	1
Quarterly	4	2
Monthly	12	3-5
Weekly	52	5-12
Daily or more	250+	25-40

8) Select the sample. Sample items should be selected in a manner that gives each item in the population an equal chance to be selected. Control procedures are expected to be applied to all transactions subject to that control. Examiners should use their professional judgment to determine a sample size from these ranges. As discussed above, examiners may select a sample that is below the given range if the control is automated and the company's ITGCs were deemed effective.

9) Document the deviations noted during the testing of controls. A deviation exists when a control is not operating effectively or as prescribed. The examiner should perform the testing of controls and document the number of deviations found as well as the reasons for those deviations. To aid the examiner's understanding of a deviation, the examiner may ask the company to provide an explanation for the deviation. The examiner should document the nature and extent of the deviations, which should include the examiner's opinion of the probability of similar deviations occurring. Deviations which do not have a plausible and verifiable explanation are considered exceptions.

10) Conclude on the final assessed level of risk management. If zero deviations are discovered during the testing of controls, the results of the test can be accepted and the examiner should use professional judgment to conclude on the final assessed level of risk management achieved from the test. For example, if the examiner tested a sample size of 40 and had no deviations, the examiner would generally conclude that the final assessed level of risk management is strong. If deviations are discovered during the testing of controls, the examiner should use professional judgment to determine the level of reliance that may be placed on the controls.

d. Non-Statistical Sampling

Non-statistical sampling is a technique designed to assist examiners with Phase 5 detail testing of dollar balances. Since this technique involves determining the accuracy of dollar balances, the concept of materiality applies. A

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common example of non-statistical sampling is testing reinsurance recoverable balances for existence and collectability.

A step-by-step approach has been provided below to assist examiners with non-statistical sampling.

1) Describe the objective of the test. The objective of the test should be defined, which usually includes determining whether an account balance or class of transactions is correctly stated.

2) Define the population, population characteristics and an individual sampling unit. The definition of the population should describe all possible items that will be included in the selection process. The examiner should also identify and document the source that the sample will be selected from including the report name. An individual sampling unit should describe the type of item available for selection. A specific definition is especially important in instances where sub-accounts or sub-totals are involved.

3) Describe how completeness of the population was considered. The examiner should determine that the population contains all appropriate items available to select in the sample. If the examiner is performing a detail test relating to an asset balance, a simple scanning or analytical review of the population should be sufficient to consider completeness.

However, if the examiner is performing a detail test relating to a liability balance, additional review and testing for completeness may be necessary. Completeness is an examination assertion that confirms that all transactions and events that should have been recorded have been recorded. The completeness assertion is particularly important for data used in the determination of liabilities because this assertion addresses understatement that could result from omitted items. As a result, the sample used to test completeness cannot be drawn from the population of recorded items being tested. In order to detect omitted items, the examiner should select items from an independent or reciprocal source of information related to the account being tested. Such sources include bank statements, physical policy or claim file inventories or other sources noted during procedures within the planning process to understand the company and identify key functional activities. Since insurance companies are often highly automated, the examiner should be careful that the source selected is truly independent and not simply a differently formatted report from the database being tested.

4) Determine individually significant items. Determining the scope for individually significant items is a two-step process. First the examiner identifies tolerable error set during the calculation of planning materiality. In the worksheet (Part Two of Exhibit O), tolerable error is assumed to be 50% of Planning Materiality. Then the examiner should set a scope for individually significant items at a percentage of tolerable error. The worksheet automatically sets this scope by using one-third (1/3) of the tolerable error amount. Any individual items that are over the calculated scope should be 100% tested and removed from the population. The 50% and 1/3 indicated above are generally used but may be adjusted by the examiner based on professional judgment. The worksheet (Part Two of Exhibit O) will automatically calculate the tolerable error and the scope for individually significant items after the examiner enters the planning materiality in the appropriate box.

Other items may be selected by the examiner for 100% testing based on their characteristics. For example, related-party transactions may not fall within the scope based on the calculations above but the examiner may want to test all related-party transactions. The examiner may also test any unusual balances or transactions deemed necessary.

After identifying individually significant items, and before proceeding with sampling from the remaining population, the examiner should use professional judgment to determine whether the individually significant items give the examiner sufficient evidence to mitigate the risk identified. If the examiner determines that there is no need to sample from the remaining population, this determination should be adequately documented in the examination workpapers and the remaining steps in this process would not be completed.

5) Stratify the population (*Part 1*) and the sample (*Part 2*). This step is performed in two separate parts. The first part of this step is stratifying the population and can be performed sequentially with the other steps. The

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second part of this step involves stratifying the sample and can be performed only after calculating the sample size in Step 7.

Part 1 – Based on the population's characteristics, the examiner should determine whether the population should be stratified. Stratification is performed by dividing, separating or arranging items into subgroups, classes or buckets (strata). When using non-statistical sampling, every sampling unit within a particular stratum should have a chance of being selected. Stratification of the population would allow the examiner to select more sample items from the higher dollar stratum. The sampling population should be stratified so that the sample size can be related to the dollar size of each stratum. For example, more items can be selected from the stratum that consists of the top 1/3 of the sampling population.

Part 2 – As mentioned above, this part of the step should be performed after calculating the sample size in Step 7 has been completed. The examiner must stratify the total sample size into the strata. Individual items in each stratum can then be selected randomly, usually up to a proportion of the sample which roughly approximates the stratum's proportion of the population. For example, if a sample is stratified where 70% percent of the total balance is in Strata A and the remaining 30% of the balance is in Strata B, approximately 70% of your selections should be chosen from Strata A and 30% should be chosen from Strata B. In this example, if your calculated sample size equals 10, then 7 selections should be tested from Strata A and 3 selections should be tested from Strata B.

6) Determine the assurance factor. In order to accomplish this step, the examiner must know the assessment of the residual risk being tested. The examiner should also identify other Phase 5 exam procedures, such as analytical review procedures, that will provide assurance related to the residual risk identified. If an examiner is performing additional Phase 5 tests that have similar testing objectives, the level of reliance may be high or moderate, as long as few errors or issues were noted in that testing. Alternatively, if the examiner is not performing additional substantive testing for the same exam objectives, the degree of reliance would be low, thus increasing the sample size.

Use the following chart and find the intersection of residual risk and the level of reliance on other exam procedures to determine the assurance factor. The assurance factor will be used in Step 7 to help calculate a sample size.

Assurance Factor Calculation

	Level of Reliance on Other Phase 5 Procedures		
Residual Risk	Low	Moderate	High
High	3.0	2.3	1.9
Moderate	2.3	1.9	1.2
Low	1.9	1.2	0.9

7) Calculate the sample size. The sample size is calculated as follows:

$$\frac{\text{Sampling Population}}{\text{Tolerable Error}} \times \text{Assurance Factor} = \text{Sample Size}$$

The sampling population is calculated by subtracting (1) Items to be tested 100%, (2) Items tested in other ways, and (3) Items not to be tested, from the total population amount. The tolerable error (usually 50% of Planning Materiality) was calculated in Step 4 above. The assurance factor was determined from the chart in Step 6 above. Use the equation to calculate the sample size based on these pre-determined factors.

Professional judgment should be used by the examiner to determine whether the calculated sample size is sufficient. The examiner should document the reasoning or justification for adjusting the sample size.

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After the final sample size is calculated, the examiner should allocate the sample size among the sampling strata. The examiner should describe the basis of allocation and provide the sample breakdown for each stratum (this would be performed in *Part 2* of Step 5 above).

8) Select the sample and perform testing. The sample should be selected in a way that is free from bias and representative of the entire population. Examiners should briefly explain the method they used to choose their selections and should also explain the stratification of the sample (if required). Once selections have been made, the examiner can proceed with testing.

9) Determine the total error. After the examiner has performed testing, the examiner should determine the total error. To do this, the examiner will use the errors found in the sample and calculate an error rate for each stratum. This error rate will then be applied to the entire stratum's population to produce a projected error. For example, an examiner is testing a stratum of $100 and chooses to test a sample of $10 worth of these items. Through testing, the examiner identifies a $1 exception in the $10 worth of items tested (generating an error rate of 10%). The examiner would then apply this 10% error rate to the population of the stratum to estimate a projected error of $10 in the $100 stratum. The examiner calculates the projected error for each stratum with the following equation:

$$\frac{\text{\$ Amount of Error in Sample}}{\text{\$ Amount of Strata's Sample}} \times \text{\$ Amount of Strata's Population} = \text{Projected Error}$$

The examiner should sum the projected errors for each stratum to accumulate the total projected error for the population. Considering that projected errors are estimates, examiners may wish to seek additional information or guidance before proposing an adjustment to the company.

10) Conclude on the acceptability of the test results. If deviations are discovered during testing, the examiner should ask the company to provide an explanation to help develop an understanding of the nature and extent of the deviations. The examiner should also understand how the test results affect other areas of the examination. If the company provides plausible explanations which indicate no chance of the error reoccurring, the examiner should document an explanation for why the selection should not be considered as an exception. If the company is unable to provide acceptable explanations for the deviations, then the results of the test must be rejected and the examiner should consider alternative procedures.

11) Perform alternative procedures (when results of a sampling test cannot be accepted). An examiner has several options when the results of a test cannot be accepted. After documenting the results of the test, the examiner may consider designing a different test to determine if the residual risk can be addressed through an alternate manner. The examiner can also ask the company to assist with additional testing. If concern remains after an examiner has exhausted all alternative options, the examiner should communicate this finding with other members of the exam team as the failed testing result may affect other areas of the exam. The examiner may also consider communicating the finding in the exam report or as a management letter comment, as appropriate.

e. Attribute Sampling

Attribute sampling is a method to estimate the deviation rate of a certain characteristic or attribute in a larger population. It is important to note that this deviation rate is not estimated as a monetary amount. Attribute sampling can be a tool for examiners to test the accuracy of items that are not quantifiable in dollars, such as the accuracy of non-monetary actuarial data elements (e.g. key dates, policy attributes, etc.). Examiners should use the following process to assist in detail testing attributes:

1) Determine the objective of the test. The objective of an attribute test is to verify that the desired attributes are present and accurate within the selected sample. Common objectives for which attribute sampling might be utilized include "Verify the accuracy and completeness of claims data" for P&C companies or "Verify the accuracy and completeness of in-force data used in formulating reserve calculations" for Life companies.

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2) Define the period covered by the test.

3) Define the population, population characteristics and a sampling unit. The definition of the population should describe all possible items that will be included in the selection process. The examiner should also identify and document the source that the sample will be selected from, including the report name. A sampling unit should describe the type of item that is available for selection and will be subjected to testing.

4) Describe how the completeness of the population was considered. The examiner should determine that the population contains all appropriate items available to select in the sample. When possible, the examiner should confirm the completeness of the database through comparison to external sources. This can be accomplished by performing reconciliations to a reciprocal population, analytical procedures, or confirming that samples pulled from the reciprocal population are included in the database to be tested. Developing a test of completeness will vary from company to company and requires a solid understanding of the company and available data. Examiners should document their rationale and methods used to ensure completeness.

5) Define a deviation (error). A deviation in attribute sampling is an improper representation of an attribute from a sampling unit. A deviation could also be defined as a selection for which the company is unable to provide sufficient evidence of the attribute being tested. A deviation occurs when the attribute being examined is incorrect or the attribute being verified does not exist. A deviation or error that cannot be explained by the company is considered an exception.

6) Determine Selection Technique. Sample items should be selected in a manner that gives each item in the population an equal chance to be selected.

In particular circumstances it may be appropriate to stratify an attribute sampling population. For example, when testing the appropriateness of assumptions and methodologies utilized in determining the reserve amount, the examining actuary might request that the population be stratified by different lines of business or experience. Stratification may also be considered when a company has multiple computer systems for processing claims that consolidate into a company-wide reporting system for all claims. Since attribute sampling is not testing a dollar balance, it would be not be appropriate to stratify the population by dollar amount. Instead, the population should be segmented by some other characteristic that differentiates each transaction being tested (e.g. system used to process claims/transactions, line of business, etc.)

7) Determine the Sample Size. The examiner should use the level of residual risk assessed in Phase 4 to determine the sample size. For example, if the residual risk assessment in Phase 4 is moderate and no other Phase 5 procedures are being performed related to the risk identified, the examiner should use the corresponding column on the chart below to determine their sample size.

In determining the sample size, an examiner should use professional judgment to consider what reliance will be placed on audit work. The examiner should evaluate the sample size used by the auditors and determine if the sample size is reasonable based on the examiner's professional judgment. The examiner should also consider the level of evidence selected by the auditors and the assessed level of residual risk. If the auditor's desired level of evidence matches the residual risk level, the examiner may accept the results of the auditor's testing with no additional selections or testing required. If the residual risk is higher than the level of evidence used by the auditors, the examiner may still leverage the audit work; however, the examiner will need to independently test additional selections so that the total sample size matches the chart below.

For populations with less than 250 items, the examiner should use professional judgment in determining the sample size and should also include a brief explanation of the rationale used to determine the sample size. Examiners may use the Test of Controls sampling chart as a reference for determining appropriate sample sizes.

For populations greater than 250 items, examiners may use the following chart to assist in determining Phase 5 attribute sample sizes:

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Determining a Sample Size
Use the number of sampling units within the defined population and the desired level of evidence to determine your sample size.

**Assumes zero exceptions*

	Residual Risk			
Number of Items in Population	**Moderate** (with reliance on other Phase 5 procedures)	**Moderate** (no reliance on other Phase 5 procedures)	**High** (with reliance on other Phase 5 procedures)	**High** (no reliance on other Phase 5 procedures)
Less than 250	*Use Professional Judgment*			
250 or more	**20**	**40**	**60**	**?**

After selecting the proper sample size, perform the testing and determine the number of exceptions identified.

- *If 0 exceptions were identified*: The results of the test can be accepted. No further work is necessary.
- *If 1 exception was identified*: Additional testing is required. Use the chart below and add the corresponding number of selections to your original sample.
- *If 2 or more exceptions identified*: The examiner should discuss the exam findings with the company to determine the cause of the errors and consider alternative procedures.

Add the amounts from this chart to your original sample size if 1 exception was identified.				
Number of Items in Population	**Moderate** (with reliance on other Phase 5 procedures)	**Moderate** (no reliance on other Phase 5 procedures)	**High** (with reliance on other Phase 5 procedures)	**High** (no reliance on other Phase 5 procedures)
Less than 250	*Use Professional Judgment*			
250 or more	**+10**	**+20**	**+30**	**+40**
Total Sample Size	**30**	**60**	**90**	**120**

Perform testing on the additional selections and determine the number of exceptions identified in the additional selections.

- *If 0 exceptions were identified in the additional selections*: The results of the test can be accepted. No further work is necessary.
- *If 1 or more exceptions were identified in the additional selections*: The examiner should discuss the exam findings with the company to determine the cause of the errors and consider alternative procedures.

8) Conclude on the acceptability of the results. When exceptions are found, it is important to understand the nature and cause of the exception. In attribute sampling the concept of materiality is not considered quantitatively. Examiners should communicate with the company to determine the source of the error and determine if similar errors are likely to exist. After the company provides an explanation for an exception, the examiner should use professional judgment to determine the amount of risk that still remains. If plausible and verifiable explanations are provided which indicate no chance of the error reoccurring, the examiner should document an explanation for why the selection should not be considered an exception. If the company is unable to provide acceptable explanations for the exceptions, the results of the test must be rejected and the examiner should consider alternative procedures. When the error affects input data for other examination items such as actuarial calculations, the error should be communicated to any examination team members who had planned to place reliance on the completeness and accuracy of the data.

9) Perform alternative procedures (when results of a sampling test cannot be accepted). An examiner has several options when the results of a test cannot be accepted. After documenting the results of the test, the examiner may consider designing a different test to determine if the residual risk can be addressed through an alternate manner. The examiner can also ask the company to assist with additional testing. If concern remains after an examiner has exhausted all alternative options, the examiner should communicate this finding with other

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members of the exam team as the failed testing result may affect other areas of the exam. The examiner may also consider communicating the finding in the exam report or as a management letter comment, as appropriate.

D. Business Continuity

Reviewing an insurer's business continuity plan is an established part of Financial Condition Examinations through testing and review performed in conjunction with the completion of the Information Technology Review. However, natural disasters, terrorism concerns and new business practices have led to a heightened need for management to plan for the prospective risks associated with business continuity including the risk to the financial solvency of the insurer. As such, business continuity planning has expanded beyond its initial information systems focus of disaster recovery plans to encompass issues such as natural and man-made disasters like terrorism, fraud, fire, loss of utility services, personnel losses and new laws and regulations. Therefore, it is important that an insurer's business continuity plan be considered throughout all aspects of the examination and not just in the context of a review of the insurer's information systems.

For all insurers, the business continuity process consists of identifying potential threats to an organization and developing plans to provide an effective response to ensure continuation of the company's operations. The objectives of the business continuity process are to minimize financial losses; continue to serve policyholders and financial market participants; and to mitigate the negative effects disruptions can have on an insurer's strategic plans, reputation, operations, liquidity, credit ratings, market position and ability to remain in compliance with laws and regulations. The guidance below provides examiners additional information about the business continuity process a typical insurance company may use. The guidance does not create additional requirements for insurers to comply with but should be used by examiners to assess the appropriateness of the company's business continuity process.

Some of the basic steps all insurers would expect to have in their business continuity processes consist of:

1. Understanding the Organization

   To develop an appropriate business continuity plan, an insurer must first understand its organization and the urgency with which activities and processes will need to be resumed in the event of a disruption. This step includes performing an annual business impact analysis and a risk assessment. The business impact analysis identifies, quantifies and qualifies the business impacts of a disruption to determine at what point in time the disruption exceeds the maximum allowable recovery time. This point in time is usually determined separately for each key function of the insurer. The risk assessment reviews the probability and impact of various threats to the insurers operations. This involves stress testing the insurer's business processes and business impact analysis assumptions with various threat scenarios. The results of the risk assessment should assist the insurer in refining its business impact analysis prior to developing a business continuity strategy.

2. Determining Business Continuity Strategies

   Under this step in the process, the insurer determines and selects business continuity management strategies to be used to continue the organization's business activities and processes after an interruption. This step should use the outputs of step one above to determine what business continuity strategies the insurer will pursue. This includes determining how to manage the risks identified in the risk analysis process. The strategies should be determined at both the corporate and key functional level of the insurer.

3. Developing and Implementing a Business Continuity Plan

   The purpose of the business continuity plan is to identify in advance the actions necessary and the resources required to enable the insurer to manage an interruption regardless of its cause. The plan should be a formal documentation of the insurer's business continuity strategy and should be considered a "living document." Some basic elements that should be included in a business continuity plan include:

   - Crisis management and incident response
   - Roles and responsibilities within the organization

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- Recovery of all critical business functions and supporting systems
- Alternate recovery sites
- Communication with policyholders, employees, primary regulators and other stakeholders

The business continuity plan should be written and should include a step-by-step framework that is easily accessible and able to be read in an emergency situation.

4. Testing and Maintenance

A company's business continuity plan cannot be considered reliable until is has been reviewed, tested, and maintained. The testing should be based on a methodology that determines what should be tested, how often the tests should be performed, how the tests should be run and how the tests will be scored. It is recommended that key aspects of the plan be tested annually and that the test be based on clear objectives that will allow the results of the test to be scored to determine the effectiveness of the business continuity plan. In addition to testing the plan, the plan should be maintained and updated regularly to ensure that the organization remains ready to handle incidents despite internal and external changes that may affect the plan.

Examiner Review of Business Continuity Plans

Reviewing the insurer's business continuity plan is a vital part of assessing the company's prospective risk. When evaluating the company's business continuity plan, the examiner should first become familiar with the work completed on the insurer's business continuity plan during the review of the company's information systems, which may include reviewing the insurer's business continuity plan to determine any of the following:

- Whether the plan is current, based on a business impact analysis, tested periodically and developed to address all significant business activities;
- Whether the business continuity plan clearly describes senior management's roles and responsibilities associated with the declaration of an emergency and implementation of the plan;
- Whether a list of critical computer application programs, data and files has been included in the plan;
- Whether a restoration priority has been assigned to all significant business activities;
- Whether user departments have developed adequate manual processing procedures for use until the electronic data processing function can be restored;
- If copies of the plan are kept in relevant off-site locations;
- If current backup copies of programs, essential documents, records and files are stored in an off-premises location;
- Whether a written agreement or contract exists for use by IT of a specific alternate site and computer hardware to restore data processing operations after a disaster occurs; and
- Whether the business impact analysis is periodically reviewed to determine the appropriateness of maximum recovery times.

After the examiner has become familiar with the work completed on the insurer's business continuity plan during the review of the information systems, the examiner should consider what additional work should be performed to determine whether the insurer has established an appropriate business continuity plan. Examples of additional procedures that may need to be performed include the following:

- Determine if the board has established an appropriate enterprise-wide business continuity planning process and if the board reviews and approves the business continuity plan on an annual basis.
- Determine if senior management periodically reviews and prioritizes each business unit, department, and process for its critical importance and recovery prioritization.
- Determine if senior management has evaluated the adequacy of the business continuity plans of its service providers and whether the capabilities of the service provider are sufficient to meet the insurer's maximum recovery times.

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- Review the business continuity plan to determine whether the plan takes into account business continuity risks not related to information technology such as public relations, human resource management and other factors.
- Perform additional procedures as necessary based on the risks of the insurer being examined.

E. Using the Work of a Specialist

1. Decision to Use the Work of a Specialist

Education and experience enable the examiner to be knowledgeable about insurance matters in general, but the examiner is not expected to have the expertise of a person trained for or qualified to engage in the practice of another profession or occupation. During the examination, an examiner may encounter matters potentially material to the current or prospective solvency of the insurer that require special knowledge and, in the examiner's judgment, require using the work of a specialist. The department should have on staff or be able to contract the requisite expertise to effectively examine any insurer. The requisite expertise should be determined by the character and nature of the domestic industry.

Examples of matters that may necessitate the work of a specialist include, but are not limited to, the following:

a. IT Review and assessment of applications (e.g., EDP environment and controls, computer audit techniques and expert systems).

b. Valuation of invested assets and portfolio analysis (e.g., real estate, restricted securities and other complex investment holdings).

c. Determination of amounts derived and risks associated with specialized techniques or methods (e.g., certain actuarial determinations, pricing and liquidity).

d. Interpretation of technical requirements, regulations, or agreements (e.g., the potential significance of reinsurance and other contracts or other legal documents, or legal title to property).

In certain situations, an examination requires the use of a specialist to effectively examine an insurer. These situations include the following:

a. Life and Health company examinations where the company has a substantial amount of interest-sensitive business or with a substantial amount of business subject to principle-based reserve (PBR) calculations or exclusion tests requiring the involvement of a credentialed actuary to perform an evaluation of reserves.

b. Property & Casualty company examinations where the company has a substantial amount of long-tail lines of business requiring the involvement of a credentialed actuary to perform an evaluation of loss reserves.

In all other situations, the decision to use a specialist is at the discretion of the examination team in consultation with the chief examiner or designee.

2. Selecting a Specialist

The department should obtain satisfaction concerning the professional qualifications and reputation of an outside specialist by inquiry or other procedures, as appropriate. The department should consider the following:

a. The professional certification, license, or other recognition of the competence of the specialist in his/her field, as appropriate.

b. The reputation and standing of the specialist in the views of his/her peers and others familiar with his/her capability or performance.

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c. The relationship, if any, of the specialist to the company.

d. Prior experience of the specialist in working on examinations.

3. Determining the Involvement of and the Work to be Performed by the Specialist

Typically, the use of a specialist should be determined during examination planning, preferably well in advance of fieldwork. An understanding should exist among the department, including the examiner-in-charge, the company and the specialist about the nature of the work to be performed by the specialist. This understanding should be documented in the Exam Planning Memorandum by covering the following:

a. The specialists' role in the risk assessment process, including interviews, selection of key activities and the development of risk statements.

b. The planned objectives and scope of the specialists' work.

c. The specialists' representations as to their relationship, if any, to the company.

In certain situations, it may be difficult to determine that a specialist is needed prior to performing risk assessment procedures. In these cases, the exam team may still elect to involve a specialist by adequately documenting the rationale for this decision in the examination workpapers without amending the Exam Planning Memorandum.

4. Documentation of Work Performed by the Specialist

The examiner-in-charge should communicate with the specialist as to the appropriate documentation of the work performed by the specialist. It should be determined upfront with the specialist who is responsible for the completion of the risk matrix and supporting documentation. Regardless of who is responsible for completing the risk matrix in a particular area, the work performed is required to clearly document a consideration of all seven phases of the risk-focused examination process. The work should also be completed in accordance with the guidance outlined in the standard examination procedures regarding examination documentation, including sufficient documentation on all conclusions.

5. Review and Use of the Findings of the Specialist

Although the appropriateness and reasonableness of the work performed is the responsibility of the specialist, the examiner-in-charge should obtain an understanding of the worked performed by the specialist to determine whether the findings are suitable to meet the needs of the examination. This requires the examiner-in-charge to review the work completed by the specialist and to understand the nature and impact of any findings or exceptions identified by the specialist. This review should be demonstrated via sign-off on all significant workpapers and procedure steps completed by the specialist. In addition, the examiner-in-charge is responsible for incorporating these findings into the examination report, management letter or ongoing supervisory plan of the insurer, but may request the assistance of the specialist in developing these items.

6. Additional Considerations for Commonly Used Specialists

IT Specialist

The use of an IT specialist in performing an IT Review should be considered for all multi-state examinations. However, examinations of less-complex IT systems or systems where extensive test documentation is already available (e.g., external audit work, SSAE 18 reports, etc.) may minimize the need to involve an IT specialist. When selecting IT specialists, the examination team should keep in mind designations indicating that specialists have met specific training and educational requirements, such as CISA, AES, CITP, CRISC, etc. For more guidance on the use of an IT specialist during an examination, see Section 1 Part III A on General Information Technology Review.

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Reinsurance Specialist

The use of a reinsurance specialist should be considered for examinations of insurers with complex and sophisticated reinsurance programs. Scenarios under which it may be appropriate to utilize a reinsurance specialist include but are not limited to the following:

- The reinsurance program includes restrictions on levels and concentrations of reinsurance that do not appear normal;
- Excessive bonus or other unusual remuneration or incentives for management are tied to the performance of reinsurance contracts;
- The insurer utilizes off-balance-sheet vehicles including structured investment vehicles and special purpose vehicles for reinsurance purposes;
- The entity holds a significant amount of reinsurance-related reserves in comparison to its overall reserves and policyholder surplus;
- The insurer carries a significant amount of reinsurance balances that demonstrate questionable characteristics (e.g., overdue, disputed, concentrations, etc.); and
- For property and casualty insurers, the entity responded affirmatively to General Interrogatories – Part 2: 7.1, 8.1, 9.1, 9.2 or 9.4.

When selecting reinsurance specialists, the examination team should keep in mind designations indicating that specialists have met specific training and educational requirements, such as ARe, ARA, etc. For more guidance on specific reinsurance review procedures during an examination, see Section 1 Part V.

Actuarial Specialist

As previously noted, the involvement of a credentialed actuary is required on all examinations of life and health insurers with a substantial amount of interest-sensitive business, with a substantial amount of business subject to principle-based reserve (PBR) calculations or subject to PBR exclusion tests and property/casualty insurers with a substantial amount of long-tail lines of business. Actuarial credentials include Fellow (or Associate) of the Casualty Actuarial Society (FCAS/ACAS) for property and casualty lines as well as Fellow (or Associate) of the Society of Actuaries (FSA/ASA) or Member of the American Academy of Actuaries (MAAA) for life and health lines. In addition to situations where the use of a credentialed actuary is required, there are many other situations in which the use of an actuarial specialist would be appropriate, such as pricing, liquidity, and reinsurance risk. Therefore, it is recommended that considerations regarding the use of an actuarial specialist be documented on all multi-state examinations. In addition to the use of credentialed actuaries, other individuals may be considered for use as actuarial specialists if they have training, experience and education providing them with an appropriate background for this role. This may include individuals in the process of obtaining actuarial credentials (e.g., completed some of the actuarial exams) with degrees in actuarial science, mathematics and statistics. The NAIC's support staff will be available to provide actuarial expertise and/or be consulted as to whether the use of an actuarial specialist would be appropriate to the circumstances.

Investment Specialist

The use of an investment specialist should be considered for examinations of insurers with complex investment portfolios. Scenarios under which it may be appropriate to utilize an investment specialist include but are not limited to the following:

- The insurer maintains a significant position greater than its competitors' averages in any of the following investment categories:
    - Bonds with call options and varied payment timing
    - Foreign investments

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- Hybrid capital securities
- Mezzanine loans
- Affiliated investments
- RMBS, CMBS, ABS CO/CLO or similar bond collateral types
- Structured securities on negative watch

- The insurer participates in derivative trading;
- The insurer participates in securities lending, repurchase and reverse repurchase transactions; and
- The insurer has significant exposure to liquidity and asset/liability matching risks.

Investment specialists generally have one or more designations indicating they have completed the specific training and educational requirements, including IPIR, FRM, CIMA, CFA, etc.

7. Controlling Exam Costs When Utilizing the Work of an Outside Specialist

When the examiner utilizes the work of outside specialists, exam costs may rise. The examiner should have sufficient oversight of the specialist's work to minimize the examination costs. As the procedures for utilizing specialists and independent contractors are similar, refer to Part 3 of this Handbook section, "Use of Independent Contractors on Multi-State Examinations," for more details on how to control costs when utilizing the work of a specialist.

F. Outsourcing of Critical Functions

The examiner is faced with additional challenges when the insurer under examination outsources critical business functions to third-parties. It is the responsibility of management to determine whether processes which have been outsourced are being effectively and efficiently performed and controlled. This oversight may be performed through a number of methods including performing site visits to the third-party or through a review of SSAE 18 work that has been performed. In some cases, performance of site visits may even be mandated by state law. However, regardless of where the business process occurs or who performs it, the examination must conclude whether financial solvency risks to the insurer have been effectively mitigated. Therefore, if the insurer has failed to determine whether a significant outsourced business process is functioning appropriately, the examiner may have to perform testing of the outsourced functions to ensure that all material risks relating to the business process have been appropriately mitigated. The guidance below provides examiners additional information about the outsourcing of critical functions a typical insurance company may utilize. The guidance does not create additional requirements for insurers to comply with beyond what is included in state law, but may assist in outlining existing requirements that may be included in state law and should be used by examiners to assess the appropriateness of the company's outsourced functions. Within the guidance, references to relevant NAIC Model Laws have been included to provide examiners with guidance as to whether compliance in certain areas is required by law. To assist in determining whether an individual state has adopted the provisions contained within the referenced NAIC models, examiners may want to review the state pages provided within the NAIC's *Model Laws, Regulations and Guidelines* publication to understand related legislative or regulatory activity undertaken in their state.

Types of Service Providers

Insurance companies have been known to outsource a wide range of business activities including sales & marketing, underwriting & policy service, premium billing & collections, claims handling, investment management, reinsurance and information technology functions. There are a number of different types of entities that accept outsourced business from insurers including the following:

- Managing General Agent – Person who acts as an agent for such insurer whether known as a managing general agent, manager or other similar term, who, with or without the authority, either separately or together with affiliates, produces, directly or indirectly, and underwrites an amount of gross direct written premium equal to or more than five percent (5%) of the policyholder surplus as reported in the last annual statement of the insurer in

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any one quarter or year together with the following activity related to the business produced adjusts or pays claims in excess of $10,000 per claim or negotiates reinsurance on behalf of the insurer.

- Producer – An insurance broker or brokers or any other person, firm, association or corporation, when, for any compensation, commission or other thing of value, the person, firm, association or corporation acts or aids in any manner in soliciting, negotiating or procuring the making of an insurance contract on behalf of an insured other than the person, firm, association or corporation.

- Controlling Producer – A producer who, directly or indirectly, controls an insurer.

- Custodian – A national bank, state bank, trust company or broker/dealer which participates in a clearing corporation.

- Investment Adviser – A person or firm that, for compensation, is engaged in the act of providing advice, making recommendations, issuing reports or furnishing analyses on securities. In addition to providing investment advice, some investment advisers also manage investment portfolios or segments of portfolios. Other common names for investment advisers include asset managers, investment managers and portfolio managers.

- Affiliated Service Provider – An affiliated person or firm to which the insurer outsources ongoing business services, including cost sharing services and management services.

- Other Third-Party Administrators – Other third-party entities that perform business functions of the insurer.

Additional information on each of the above types of entities has been provided below to assist examiners in reviewing business activities outsourced.

Managing General Agents

Specific qualifications and procedures for managing general agents (MGAs) to follow are outlined in the NAIC's *Managing General Agents Act* (Model #225). The examiner should consider performing the following steps to ensure that risks in this area have been appropriately mitigated when examining an insurer that utilizes MGAs:

1. Review the licenses of all MGAs:

    a. Note the effective and expiration dates of licenses; and

    b. Note if each MGA is licensed to represent the insurer domiciled in this state.

2. Review all contracts between MGAs and insurance companies:

    a. Each contract must contain a clause that the insurance company may cancel the contract for any reason, upon written notice to the MGA;

    b. Note the limitations each contract places on the MGA with respect to amount of risk insured, geographical location of risk or any other limitations detailed in contract; and

    c. The contract should specifically prohibit the MGA from binding the insurance company to any reinsurance.

3. Sample policies produced by each MGA:

    Each policy must fall within the financial and geographical limitations imposed by each contract with the respective insurance companies.

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4. Sample financial accounts submitted by the MGA:

    a. All accounts must be submitted quarterly and within a reasonable amount of time after the end of each quarter; and

    b. All accounts should be in a format and contain such information that will enable an insurance company to use the accounts to properly complete its annual statement.

5. Review internal controls over cash transactions between insurance companies and MGAs:

    a. All funds collected by the MGA on behalf of the insurance company must be deposited in a separate fiduciary account in a bank that is a member of the Federal Reserve System. This account should be owned and controlled by the insurance company;

    b. All funds owed to the insurance company by the MGA should be paid on a timely basis; and

    c. The MGA may retain no more than three months worth of loss and allocated loss expense payments in the fiduciary account owned and operated by the insurance company.

6. Review the insurance company's procedures for monitoring each MGA's activities:

    a. The insurance company should obtain, at least annually, a certified public accountant's report on the business produced by each MGA as well as an opinion of an actuary attesting to the adequacy of loss reserves on business produced by each MGA;

    b. The insurance company should periodically conduct an audit of each MGA's operations; and

    c. The insurance company should make sure that only an officer of the company, who is not affiliated with an MGA, has the authority to bind the insurer's any reinsurance on any participation with syndicates.

Insurance Producers

An insurance producer sells, solicits or negotiates insurance on behalf of an insurer and receives compensation or commission. Individuals who are officers, directors, employees and subsidiaries, or affiliates of a company, who do not receive commission from policies written or sold and perform duties unrelated or only indirectly related to the sale, solicitation or negotiation of insurance, are not considered to be insurance producers. Individuals or business entities practicing as insurance producers must maintain a resident or nonresident producer license, when mandated by state law. In order to receive an insurance producer license, individual applicants must pass a written examination that tests the following: the lines of authority for which application is made, the duties and responsibilities of insurance producers and the state's insurance laws and regulations.

Insurance producers may receive a license in one or more of the following lines of authority or in any other insurance type permitted under state law:

- Life
- Accident and Health or Sickness
- Property and Casualty
- Variable Life or Variable Annuity Products
- Personal Lines
- Credit

Once an individual or company receives an insurance producer license, the license will remain in effect, unless revoked or suspended, as long as the correlating fees are paid and education requirements are met. Licensed producers are maintained on the NAIC's Producer Database.

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If insurance producers violate the governing provisions in the NAIC's *Producer Licensing Model Act* (Model #218), the insurance commissioner may terminate, suspend, or non-renew the insurance producer license. Insurance commissioners may also levy civil penalties against insurance producers if considered necessary.

Notification should be provided to the commissioner when insurers terminate relationships (i.e., agency contracts) with insurance producers either with or without cause. The insurer is required to provide information to the commissioner, if requested, regarding the relationship termination and activity of the producer.

HMO Producers

Health Maintenance Organizations (HMOs) are also permitted to have insurance producers if appropriately licensed. To receive an HMO insurance producer license, in addition to the basic requirements of insurance producers, the HMO producer is required to demonstrate financial responsibility and the reasonable protection of customers. The HMO producer usually completes this requirement by issuing bonds, deposits or other means as specified by the department. Like insurance producers, the license of a HMO producer can be denied, suspended or terminated by the state department.

If required by the state, HMO licensed producers shall be appointed to solicit, negotiate, procure or renew HMO membership contracts on behalf of a HMO. Notification of HMO producer appointments is required to be communicated to the state's insurance department. Termination of HMO appointments may occur upon written notification to the state insurance department by either the HMO producer or the HMO.

Controlling Producers and Controlled Insurers

Controlling producers are licensed producers, (see above) who through contracts are able to directly and/or indirectly influence the direction of the controlled insurers management and policies. As with insurance producers, controlling producers receive compensation, commission, or other forms of monetary payment from controlled insurers in return for soliciting, negotiating, or procuring insurance contracts on behalf of the insurer. According to the NAIC's *Business Transacted with Producer Controlled Property Casualty Insurers Act* (Model #325), controlling producers who provide gross written premiums equal to or greater than 5% of the controlled insurers admitted assets as reported on the controlled insurers quarterly statement filed as of September 30 of the prior year, are generally required to maintain compliance with specific contract guidelines, obtain requisite commissioner approval, and provide disclosure to the insured prior to the policy's effective date. Failing to comply with the established requirements may result in the commissioner terminating the relationship between the controlling producer and the controlled insurer and civil action to impose compensatory damages for the insurer or policyholder.

1. Requirements of Controlling Producers and Controlled Insurers

   Contracts between controlling producers and controlled insurers are required to be in writing, contain specific contract provisions if deemed necessary, and be approved by the insurers board of directors. Furthermore, the controlled insurer's audit committee is required to be comprised of independent directors who annually meet with management, CPAs, and casualty actuaries and/or loss reserve specialists to review the sufficiency of the insurer's loss reserves. The findings of the reserve specialists, with regards to the loss ratios and loss reserves established for incurred and outstanding losses for business placed by the producer, has to be reported to the controlled insurer's commissioner by April 1 every year. In order to verify that the controlling producer is not receiving undue high commissions, the commissioner must also receive detail of the commissions paid and the percentage of the respective paid commissions to the net premiums written, along with comparable data for non-controlling producers producing the same type of business.

2. Specific Contract Provisions

   Specific contract provisions between the controlling producer and the controlled insurer are required if the controlling producer meets the 5% written premium threshold as previously indicated. However, the specific contract provisions are not required if the controlling producer does not receive compensation based on the

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amount of premiums written, or the controlled insurer accepts insurance business only from a controlling producer.

The specific contract provisions are as follows:

a. Upon written notice to the controlling producer, the controlled insurer may terminate the contract for cause. The controlled insurer is entitled to suspend the controlling producer's authority to write business during the duration of any dispute regarding the cause for the termination.

b. The controlling producer shall render accounts including detail of all material transactions to the controlled insurer. This includes information necessary to support all commissions, charges and other fees received by, or owed to, the controlling producer.

c. The controlling producer shall remit all funds due under the terms of the contract to the controlled insurer on at least a monthly basis. Additionally, premiums or installments collected by the controlling producer shall be remitted no later than 90 days after the effective date of a policy placed with the controlled insurer.

d. The controlling producer shall hold all funds collected on behalf of the controlled insurer in a fiduciary capacity, in banks that are members of the Federal Reserve System, and in appropriately identified bank accounts.

e. Separate, identifiable records of business written for the controlled insurer shall be maintained by the controlling producer.

f. The controlling producer shall not assign the contract in whole or in part.

g. The controlled insurer shall provide the controlling producer with its underwriting standards, rules and procedures, manuals setting forth the rates to be charged, and the conditions for the acceptance or rejection of risks. The controlling producer shall adhere to the standards, rules, procedures, rates and conditions. The standards, rules, procedures, rates and conditions shall be the same as those applicable to comparable business placed with the controlled insurer by a producer other than the controlling producer.

h. The contract shall specify the rates and terms of the controlling producer's commissions, charges or other fees and the purposes for those charges or fees. The rates of the commissions, charges and other fees shall not be greater than those applicable to non-controlling producers for comparable business (i.e., same kinds of insurance and risks, similar policy limits, and quality of business) placed with the controlled insurer.

i. Controlling producer compensation based on insurer profits shall not be determined or paid until at least five years after the premiums on liability insurance are earned and at least one year after the premiums are earned on any other type of insurance. Commissions shall not be paid until an independent casualty actuary or loss reserve specialist has confirmed the sufficiency of the controlled insurer's reserves on remaining claims, including incurred but not reported (IBNR).

j. The contract shall specify a percentage limit of writings the controlling producer is entitled to make relative to the controlled insurer's surplus and total writings. The insurer may establish a different limit for each line or sub-line of business. Notification by the controlled insurer to the controlling producer is required when the established limit is approached. Once the limit has been reached, the controlled insurer is prohibited from accepting business from the controlling producer. The controlling producer shall not attempt to place business with the controlled insurer if it has been notified that the limit has been reached.

k. The controlling producer may bind facultative reinsurance contracts pursuant to obligatory facultative agreements if the contract with the controlled insurer contains underwriting guidelines for assumed and

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ceded business that includes a list of reinsurers with which automatic agreements are in effect, the coverages and amounts or percentages that may be reinsured, and commission schedules. Otherwise, for business placed by the producer, the controlling producer is entitled to negotiate but is unable to bind reinsurance on behalf of the controlled insurer.

Custodial or Safekeeping Agreements

Specific requirements related to an insurance company's utilization of systems for holding and transferring securities are included in the NAIC's *Model Act on Custodial Agreements and the use of Clearing Corporations* (Model # 285) and the NAIC's *Model Regulation on Custodial Agreements and the use of Clearing Corporations* (Model #298). When conducting financial examinations, the custodial or safekeeping agreements should be considered and evaluated with this guidance.

1. An insurance company may, by written agreement, provide for the custody of its securities with a custodian. If permitted by the state of domicile, the custodian must either be a broker/dealer that is registered with and subject to jurisdiction of the Securities and Exchange Commission, maintains membership in the Securities Investor Protection Corporation, and has a tangible net worth equal to or greater than $250,000,000; or a national bank, federal home loan bank, or trust company which is adequately capitalized and qualified to accept securities as determined by the standards adopted by the U.S. banking regulators and regulated by state banking laws or a member of the Federal Reserve system. Custodial agreements shall be authorized by a resolution on behalf of the board of directors or an authorized committee of the insurance company. The agreement should state that certificated securities of the insurance company shall be held separate from all other securities. Those securities held indirectly by a custodian or in a clearing corporation shall be separately identified on the custodian's official records as being owned by the insurance company. Registered custodial securities shall be registered in the name of the company, in the name of a nominee of the company, in the name of the custodian or its nominee, or clearing corporation or its nominee. The securities, other than those held to meet deposit requirements, shall be held subject to the instructions of the insurance company, and shall be withdrawable upon the demand of the insurance company. Confirmation of all transfers should be provided to the insurance company in hardcopy or in electronic format.

2. Custodial or safekeeping agreements with an agent, or clearing corporation meeting the requirements herein should contain satisfactory safeguards and controls, including but not limited to the provisions provided below. For the purpose of this guidance, an agent is a national bank, federal home loan bank, trust company or broker/dealer with an account in a clearing corporation, or a member of the Federal Reserve System. A clearing corporation is a corporation as defined in Article 8 of the Uniform Commercial Code that is organized for the purpose of effecting transactions in securities by computerized book-entry, including the Treasury/Reserve Automated Debt Entry Securities System (TRADES) and Treasury Direct book entry securities systems, except those securities issued under the laws of a foreign country.

    a. The custodian is obligated to indemnify the insurance company for any insurance company's loss of securities in the custodian's custody, except that, unless domiciliary state law, regulation or administrative action otherwise require a stricter standard (Section 2.b. sets forth an example of such a stricter standard), the custodian shall not be so obligated to the extent that such loss was caused by other than the negligence or dishonesty of the custodian;

    If domiciliary state law, regulation or administrative action requires a stricter standard of liability for custodians of insurance company securities than that set forth in Section 2.a., then such stricter standard shall apply. An example of a stricter standard that may be used is that the custodian is obligated to indemnify the insurance company for any loss of securities of the insurance company in the custodian's custody occasioned by the negligence or dishonesty of the custodian's officers or employees, or burglary, robbery, holdup, theft, or mysterious disappearance, including loss by damage or destruction;

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c. In the event of a loss of the securities for which the custodian is obligated to indemnify the insurance company, the securities shall be promptly replaced or the value of the securities and the value of any loss of rights or privileges resulting from said loss of securities shall be promptly replaced;

d. The custodian shall not be liable for any failure to take any action required to be taken hereunder in the event and to the extent that the taking of such action is prevented or delayed by war (whether declared or not and including existing wars), revolution, insurrection, riot, civil commotion, act of God, accident, fire, explosions, stoppage of labor, strikes or other differences with employees, laws, regulations, orders or other acts of any governmental authority, or any other cause whatever beyond its reasonable control;

e. In the event that the custodian gains entry in a clearing corporation through an agent, there should be a written agreement between the custodian and the agent that the agent shall be subjected to the same liability for loss of securities as the custodian. If the agent is governed by laws that differ from the regulation of the custodian, the Commissioner of Insurance of the state of domicile may accept a standard of liability applicable to the agent that is different from the standard liability;

f. If the custodial agreement has been terminated or if 100% of the account assets in any one custody account have been withdrawn, the custodian shall provide written notification, within three business days of termination or withdrawal, to the insurer's domiciliary commissioner;

g. During regular business hours, and upon reasonable notice, an officer or employee of the insurance company, an independent accountant selected by the insurance company and a representative of an appropriate regulatory body shall be entitled to examine on the premises of the custodian, its records relating to securities, if the custodian is given written instructions to that effect from an authorized officer of the insurance company;

h. The custodian and its agents, upon reasonable request, shall be required to send all reports which they receive from a clearing corporation, which the clearing corporation permits to be redistributed including reports prepared by the custodian's outside auditors, to the insurance company on their respective systems of internal control;

i. To the extent that certain information maintained by the custodian is relied upon by the insurance company in preparation of its annual statement and supporting schedules, the custodian agrees to maintain records sufficient to determine and verify such information;

j. The custodian shall provide, upon written request from a regulator or an authorized officer of the insurance company, the appropriate affidavits, with respect to the insurance company's securities held by the custodian;

k. The custodian shall secure and maintain insurance protection in an adequate amount; and

l. The foreign bank acting as a custodian, or a U.S. custodian's foreign agent, or a foreign clearing corporation is only holding foreign securities or securities required by the foreign country in order for the insurer to do business in that country. A U.S. custodian must hold all other securities.

3. Except as provided below, the examiner shall verify such securities by actual inspection and count and whenever necessary ascertain whether the securities are the specific ones acquired by the company:

a. Securities on deposit with state officials need not be counted (provided) if a certificate of verification is secured directly from the custodian or insurance commissioner.

b. Where domiciliary state law, regulation, or administrative action does not prohibit the use of custodial arrangements under which actual inspection or count of specific securities acquired is not possible, and the insurance company uses such an arrangement, the examiners shall:

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- Apply the provisions of Sections d. and g. below, in cases where the custodian, under the controlling custodial or safekeeping agreement, is permitted to carry securities indirectly or otherwise commingled form;

- Apply the provisions of Sections e. and g. below, in cases where the custodian, under the controlling custodial or safekeeping agreement, directly or indirectly participates in the Treasury Reform Automated Debt Entry Securities System (TRADES) or Treasury Direct system. These systems are computerized programs sponsored by the United States department of the Treasury and certain agencies and instrumentalities of the United States for holding and transferring securities of the United States government and the agencies and instrumentalities, respectively, in Federal Reserve Banks through banks which are members of the Federal Reserve System or which otherwise have access to such computerized systems; and

- Apply the provisions of Section f. and g. below, in cases where the facilities of a clearing corporation are used, either directly or indirectly through a custodian, under the controlling custodial or safekeeping agreement.

c. Securities held by a custodian under other custodial or safekeeping arrangements need not be counted, at the discretion of the examiner-in-charge, if the following criteria are met (provided the domiciliary state laws do not require that such securities be counted and inspected during an examination):

- Examiners are furnished a copy of the custodial or safekeeping agreements;

- They are satisfied such agreement has the necessary safeguards and controls;

- The securities are held by a custodian licensed by the United States or any state thereof, and such custodian is regularly examined by the applicable licensing authority;

- The securities so deposited are at all times kept separate and apart from other deposit accounts with the custodian, so that at all times they may be identified as belonging solely to the company for which they are held;

- If such a deposit is not counted, a verification certificate signed by an authorized signatory of the custodian holding the deposit shall be secured by the examiners directly;

- Such certificate shall contain sufficient detail to permit adequate identification of the securities; and

- Such certificate may be accepted in lieu of actual count provided it meets the above requirements and the examiners are satisfied that the representation thus made is in accordance with the facts.

d. Where not prohibited by domiciliary state law and if permitted by the terms of the controlling custodial or safekeeping agreement containing satisfactory safeguards and controls, securities held by a custodian that meets the requirements of Section c. above, may be held by the custodian, in bulk as a part of a "jumbo" certificate or other system under which there is a commingling of securities held in custody. In such cases, the examiners shall:

- Obtain directly from the custodian a certified listing of the securities held as of the date of examination for the account of the insurance company under examination;

- Obtain a copy of the insurance company's listing of the securities held by the custodian for the insurance company's account as of the date of examination; and

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- Match the positions shown on the custodian's listing to the positions shown on the company's listing, and reconcile any differences.

e. Custodians which meet the requirements of Section c. above, and which either are members of the Federal Reserve System or non member banks redepositing securities with a member bank, may, when acting as custodians for insurance companies, use the Treasury/Reserve Automated Debt Entry Security System (TRADES) or the Treasury Direct book entry securities systems under a written agreement with the insurance company permitting such utilization. In such cases, the examiners shall follow the procedures set forth in Section c. above.

f. Where not prohibited by domiciliary state law, an insurance company may, under a written agreement, use the facilities of a clearing corporation, either directly or through a custodian, subject to the requirements of Section c. above. In such cases, the examiners shall:

- Obtain directly from the depository if direct deposit is used, or from the custodian if indirect deposit is used, a certified listing of the securities held in the clearing corporation as of the date of examination for the account of the insurance company under examination.

- Obtain a copy of the insurance company's listing of its securities held by the clearing corporation as of the date of examination;

- Match the positions shown on the clearing corporation's or custodian's listing to the positions shown on the company's listing, and reconcile any differences; and

- Ascertain that the securities are held by a clearing corporation regulated by the Securities and Exchange Commission, the Federal Reserve System, or the banking authorities in its state of domicile.

g. In carrying out their responsibilities under Section d, e, and f above, it is important that the examiners satisfy themselves as to the integrity of the accounting controls and verification and security procedures of the custodian and/or the clearing corporation, as the case may be. This satisfaction may be obtained by securing the most recent report on the review of the custodian's system of internal controls pertaining to custodian record keeping issued by the respective organization's independent auditors.

Investment Advisers

As investments and investment strategies grow in complexity, insurers may consider the use of investment advisers to manage their investment strategy. Investment advisers may operate independently or as part of an investment company. Investment advisers and companies are subject to regulation by the U.S. Securities and Exchange (SEC) Commission and by the states in which they operate generally based on the size of their business. In certain situations, insurers may use a broker dealer in the capacity of an investment adviser. Broker dealers are subject to regulation by the Financial Industry Regulatory Authority (FINRA). Regardless, most broker dealers and investment advisers will register with the SEC and annually update a Form ADV which provides extensive information about the nature of the organization's operations. To locate these forms, the examiner can got to *www.adviserinfo.sec.gov* and perform a search based on the company name.

Key information provided on a Form ADV includes:

a. Locations in which the adviser/broker is registered

b. Information about the advisory business including size of operations and types of customers (Item 5)

c. Information about whether the company provides custodial services (Item 9)

d. Information about disciplinary action and/or criminal records (Item 11)

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It is important to note that the information provided on Form ADV is self-reported and is subject to limited regulatory oversight. However, the information may be very valuable to examiners in assessing the suitability of investment advisers providing advisory services to insurers.

Where not prohibited by domiciliary state law and if permitted by the investment adviser agreement, there may be situations in which the investment adviser also acts as a custodian. In these instances, investment advisers are required to obtain an annual examination by an independent public accountant to verify compliance with custodial responsibilities as provided in the federal Investment Advisers Act of 1940 and/or the federal Investment Company Act of 1940. The accountant's report is also available on the Form ADV.

In performing risk-focused examinations, examiners should identify all advisers utilized by the insurer and take steps to address any significant risks associated with their use. These steps may include determining whether investment advisers are suitable for their role (including registered and in good standing with the SEC and/or state securities regulators), performing procedures to ensure investment advisory agreements contain appropriate provisions, and performing procedures to ensure that the adviser is acting in accordance with the agreement. Additionally, the examiner may consider performing procedures to determine if management/board oversight of the investment adviser is sufficient for the relationships in place.

In evaluating the provisions of the investment advisory/management agreements, examiners should consider whether there are appropriate provisions to adequately address selection of investments, authority for transactions, conflicts of interest, calculation of fees, etc. Additional considerations for use in reviewing the investment advisory/management agreements are provided as follows:

a. Selection of Investments

   It should be clear from the advisory agreement, how the investment adviser will select investments. This should include specific reference to the insurer's investment strategy.

b. Authority for Transactions

   Advisory agreements should address the level of the authority that will be given to the investment adviser in executing transactions.

c. Conflicts of Interest

   To the extent that any conflicts of interest may be known to the insurer, the advisory agreement should specifically indicate the manner in which such conflicts will be considered. This is an important protection against an investment adviser's biases as a result of business arrangement (e.g. referral relationships, affiliate product offerings, etc.) that may interfere with the proper execution of the investment strategy. For example, investment advisers often have affiliates that offer investment options that should be available to the insurer but should not be given preferential treatment if competitor products are determined to be a better fit for the selected investment strategy.

d. Fiduciary Responsibility

   Language provided in the investment management agreement should acknowledge the investment adviser's role as a fiduciary in advising the insurer. This is an important legal distinction that may help protect the insurer's interests in the execution of the company's investment strategy.

e. Calculation of Fees

   It is important that the manner in which fees are calculated is well defined in the management agreement and that the structure of the fee is considered as management assesses the adviser's performance. For example, if the advisory fee is computed based on volume of transactions, it would be important for management to closely review the frequency of trades to help avoid excessive charges.

f. Review of Performance

   Agreements should include consideration of information that will be provided to the company to permit the company to perform adequate review of the adviser's performance and execution of the investment strategy.

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There may be other terms that examiners consider to be significant and can therefore tailor their review based on judgment and the specifics of the insurer under exam.

Examiners may consider leveraging risk, control and test procedure language provided in the Investment repository when determining an appropriate examination response. The examiner may also consider concepts discussed in the "Other Third-party Administrators (TPAs)" and "Custodial or Safekeeping Agreements" to ensure that risks are adequately addressed as part of examination fieldwork.

Affiliated Service Providers

Specific requirements related to an insurance company's utilization of cost sharing services and management services with affiliates are included in the NAIC's *Insurance Holding Company System Model Regulation* (Model #450). Prior to entering into one of these agreements, an insurer must first give notice to the State Insurance Department of the proposed transaction via the Form D filing. As the receipt and review of the Form D filing is typically the responsibility of the Department Analyst, the examiner should leverage that review to the extent possible. If the agreement has not been obtained and reviewed by the analyst, or if significant agreements have not been modified since 12/31/14 (date that new provisions were effective in Model #450), the examiner should obtain and evaluate whether the agreement includes the provisions listed below:

Agreements for cost sharing services and management services shall at a minimum and as applicable:

1. Identify the person providing services and the nature of such services;
2. Set forth the methods to allocate costs;
3. Require timely settlement, not less frequently than on a quarterly basis, and compliance with the requirements in the Accounting Practices and Procedures Manual;
4. Prohibit advancement of funds by the insurer to the affiliate except to pay for services defined in the agreement;
5. State that the insurer will maintain oversight for functions provided to the insurer by the affiliate and that the insurer will monitor services annually for quality assurance;
6. Define books and records of the insurer to include all books and records developed or maintained under or related to the agreement;
7. Specify that all books and records of the insurer are and remain the property of the insurer and are subject to control of the insurer;
8. State that all funds and invested assets of the insurer are the exclusive property of the insurer, held for the benefit of the insurer, and are subject to the control of the insurer;
9. Include standards for termination of the agreement with and without cause;
10. Include provisions for indemnification of the insurer in the event of gross negligence or willful misconduct on the part of the affiliate providing the services;
11. Specify that if the insurer is placed in receivership or seized by the commissioner under the State Receivership Act:
    a. all of the rights of the insurer under the agreement extend to the receiver or commissioner; and,

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b. all books and records will immediately be made available to the receiver or the commissioner, and shall be turned over to the receiver or commissioner immediately upon the receiver or the commissioner's request;

12. Specify that the affiliate has no automatic right to terminate the agreement if the insurer is placed in receivership pursuant to the State Receivership Act; and

13. Specify that the affiliate will continue to maintain any systems, programs, or other infrastructure notwithstanding a seizure by the commissioner under the State Receivership Act, and will make them available to the receiver, for so long as the affiliate continues to receive timely payment for services rendered.

If certain provisions are missing from affiliate service agreements, the examination team should encourage/require revisions to include all appropriate provisions, depending upon the date of the agreement and provisions required by Model #450 at that date. In addition, in accordance with the risk-focused examination process and utilizing guidance from the Related Party Repository, the examiner should consider whether terms of significant affiliated agreements are fair and equitable. Examiners should also note that additional guidance for reviewing individual affiliated transactions is located in Section 1, Part IV D in this Handbook.

Other Third-Party Administrators (TPAs)

In addition to using third-parties as managing general agents, producers, controlling producers, investment advisers, investment custodians, and affiliated service providers, third-parties can be used to perform a number of other functions for the insurer. These functions may include payroll processing, claims review, claims processing, premium processing, investment management, reinsurance program management or general IT processes. Depending upon legislative and/or regulatory action in each state, TPAs performing these services in connection with life, annuity, health or worker's compensation coverage provided by an insurer may be subject to requirements as outlined in the NAIC's *Registration and Regulation of Third Party Administrators* (Guideline #1090).

It is important that the examiner gain a thorough understanding of the business functions being outsourced by the insurer and the controls that have been put in place to mitigate risks relating to those business functions. When evaluating the insurer's use of other TPAs, the examiner should first become familiar with the work completed during the IT review, as described in Exhibit C. The examination work completed in these areas is typically performed by an information technology examiner, and may focus on risks related to the IT function of the insurer. However, the work performed in this area should provide the financial examiner information on the relationship between the insurer and the TPA and on the overall controls in place over the outsourced function.

Once the financial examiner has performed a detail review of work performed during the IT review, the extent of additional testing to be performed for each TPA can be determined. This additional testing could include the following procedures:

1. Review the contract between the insurer and the TPA to determine that appropriate provisions have been included (ownership of data, termination of contract, right to review records, etc.). Those TPAs subject to Guideline #1090 may face specific requirements in these areas including licensure.

2. Perform a detailed review of any available Service Organization Reports, as described below, to determine that relevant controls are in place at the TPA and operating effectively (see additional guidance above). The examiner should note that although a Type II SOC 1 report may have been issued for the TPA, the controls tested may not mitigate the risks that concern the examiner.

3. If no Service Organization Report has been issued for the TPA, determine whether the insurer has taken appropriate steps to ensure that adequate controls are in place at the TPA and are operating effectively. The insurer may take various actions to determine the adequacy and effectiveness of controls in place at the service provider including performing periodic site visits, performing off-site reviews, and/or maintaining additional reporting requirements for the TPA. For insurer's subject to Guideline #1090, there are requirements that

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significant TPAs be subject to a semiannual review of operations. At least one such review must be an on-site audit of the operations of the TPA.

4. If the examiner determines that the work performed to determine the adequacy and operating effectiveness of the TPA's controls is insufficient, additional testing should be performed in accordance with the materiality of the function being outsourced and the specific risks identified. This additional testing could include requesting the insurer to perform additional testing of its TPA or having the examiner visit the TPA's site to perform testing on the relevant controls.

SSAE 18 and Service Organization Controls Reports

(a) Overview

As discussed above, many insurance companies use non-affiliated organizations to perform such services as data processing, payroll processing, claims processing, etc. As part of the planning process for a financial statement audit or examination of an insurer that uses a third-party service organization, the auditor or examiner should consider the internal control environment at this service organization.

The most effective means for gaining an understanding of the internal control environment at the service organization is by reviewing the Service Organization Controls (SOC) report, if available. There are several types of SOC reports, each of which adhere to standards set by the American Institute of Certified Public Accountants (AICPA) as discussed below. Gaining an understanding of the internal control environment should be beneficial to examiners in understanding the servicing entity's role and its impact on the insurer's internal controls, whether the internal control design and operating effectiveness was considered adequate by the external auditor, and whether the external auditors were able to rely on the service entity's controls. These considerations should further assist the examiner in determining the extent of individual work necessary to assess the company's significant operations that have been outsourced to service providers.

(b) Types of Service Organization Controls (SOC) Reports

SSAE 16/SOC 1

SSAE 16 is an attestation standard developed by the AICPA to provide guidance to enable an independent auditor to issue an opinion on an organization's internal controls over financial reporting (ICFR). SSAE 16 supersedes SAS 70 guidance for reports on ICFR at service organizations issued on or after June 15, 2011. The report issued under the new guidance of SSAE 16 is called the Service Organization Controls report 1, or SOC 1 (often referred to as a SSAE 16 Report). SOC 1 engagements are performed in accordance with SSAE 16 and focus solely on controls at the service organization that are likely to be relevant to an audit of a client's financial statements. SSAE 16 does not include pre-determined control objectives or control activities that organizations must achieve; rather, it is designed to provide information about the service organization's ICFR environment to user organizations and user auditors.

SSAE 18

In 2017, the AICPA further updated its attestation standards for SOC reports with the issuance of SSAE 18. The new guidance is effective for reports dated on or after May 1, 2017. Importantly, while SSAE 16 only applies to SOC 1 reports, the guidance within SSAE 18 also applies to SOC 2 and SOC 3 reports.

The reports issued under SSAE 18 are substantially similar to those issued under the former SSAE 16 with an added focus on controls at a subservice organization.

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SOC for Cybersecurity

SOC for Cybersecurity examinations are performed in accordance with the AICPA Attestation Guide "Reporting on an Entity's Cybersecurity Risk Management Program and Controls". These reports are similar to the Service SOC 2 reports discussed below, but differ in scope and therefore in the way that each report can be used. While a SOC 2 report is intended to be used by companies that use a company as a service organization and therefore need assurance over the controls in place to provide those services, a SOC for Cybersecurity report is intended for a broader audience and provides more general information about the entity's cybersecurity risk management program.

SOC 2 & SOC 3

SOC 2 and SOC 3 engagements do not fall within scope of SSAE 16. These engagements are performed in accordance with AT 101 – *Attestation Engagements and for reports issued on or after May 1, 2017, in accordance with SSAE 18*, to address system controls based on AICPA Trust Services Principles, Criteria, and Illustrations.

Unlike SOC 1 engagements, SOC 2 engagements use predefined criteria in the Trust Services Principles, Criteria, and Illustrations. In a SOC 2 report, the service auditor would specifically address one or more of the five key system attributes comprising the Trust Services Principles, Criteria and Illustrations; Security, Availability, Processing Integrity, Confidentiality, or Privacy.

Similar to the SOC 2 report, the SOC 3 report uses the predefined criteria in the Trust Services Principles, Criteria, and Illustrations. The key difference between these two reports is that the SOC 3 report is a general-use report, typically used for branding purposes by the service organization. The SOC 3 does not provide a description of the tests performed, results of testing, or the auditor's opinion on the description of the system.

In the context of this handbook, the SOC 2 report will generally be of greater use to examiners than the SOC 3 report, as the SOC 3 report does not provide its users with sufficient detail about the design and operation of controls.

(c) Type I vs. Type II

When a CPA performs a SOC 1 or SOC 2 audit or examination of a service organization, the SOC report that is issued is classified as either Type I or Type II.

Type I Report
A Type I report describes the organization's controls at a specific point in time and includes the independent auditor's report. The auditor will express an opinion on whether the organization's description of controls presents the relevant aspects of the organization's actual controls in operation as of a specific date, and whether the controls were suitably designed to achieve specified control objectives.

Type II Report
Similar to a Type I report, a Type II report includes the organization's description of controls and auditor's opinion. What differentiates the Type I report from the Type II report is that the Type II report includes detailed testing of the organization's controls for the period specified in the report, typically one year. In addition to expressing an opinion on the same items noted in a Type I report, the auditor will also indicate whether the controls that were tested were operating with sufficient effectiveness to provide reasonable, but not absolute, assurance that the control objectives were achieved during the period specified.

(d) SOC Report Section Contents

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Independent Auditor's Report (Opinion)

This report is typically a one to two-page letter from the independent auditors to the management of the service organization. The language of the opinion generally follows explicit guidelines as determined by the AICPA, including a description of the auditor's approach and the scope of the audit. For Type I and Type II engagements, the opinion should state whether the organization's description of controls presents fairly, in all material respects, the relevant aspects of the organization's controls that had been placed in operation as of a specific date (Type I) or during the period covered by the report (Type II), whether the controls were suitably designed to achieve the specific control objectives, and for Type II engagements, whether the tested controls were operating with sufficient effectiveness to provide reasonable, but not absolute, assurance that the control objectives were achieved during the period specified.

Management Assertion

Management of the service organization must provide the service auditor a written assertion that will either accompany the service auditor's report or be included within the system description. This written assertion is much like the management representation letter previously required under SAS 70 guidance. Management must assert to the fairness of the system description, the suitability of the design of controls and, for Type II engagements, the operating effectiveness of the controls. Further, if the service organization uses subservice organization(s), management of the subservice organization(s) must also provide an assertion to accompany the auditor's report.

System Description

Management of the service organization is required to provide a detailed description of the system in place at the organization. This description should include, among other things, the nature of services provided to user entities, how these services are performed, the service organization's control over the services provided, and the related control objectives. One key area to note within this section is the User Control Considerations (UCC). UCCs work hand-in-hand with internal controls. Therefore, in order for users to benefit from the SOC report, they must ensure the related UCCs are in place and functioning at the user organization. To illustrate this point, refer to the UCC example below:

> *User organizations should have controls in place to restrict access to the secure web portal that is used to transmit data to the service organization to only authorized individuals. Controls should include notifying the service organization when an individual's access is no longer required or if authentication credentials have been compromised.*

Information Provided by the Service Auditor

This section is optional in a Type I report. Examples of information that might be included in this section are a more detailed description of the objectives of a service auditor's engagement or information relating to regulatory requirements. In a Type II report, this section of the SOC report features a description of the auditor's tests of operating effectiveness of controls and the results of those tests. The following elements should be included in the description:

- The controls tested and the objectives the controls were designed to achieve; and
- An indication of the nature, timing, extent and the results of the tests supplied in sufficient detail to enable user auditors to determine the effect of such tests on their assessment of control risk. In evaluating these factors, user auditors should also keep in mind that, for certain assumptions, the shorter the period covered by a specific test and the longer the time elapsed since the performance of the test, the less support of control risk reduction the test may provide.

Other Information Provided by the Organization

A service organization may want to present other information that is not part of the description of controls. This type of information would be included in a separate section and would not be covered by the auditor's opinion. Examples of information that might be included in this section are responses to exceptions noted in the report and certifications achieved by the service organization (i.e., ISO Certification).

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(e) Examiner Considerations in using SOC Reports

SOC 1 Report
The SOC 1 report is the most common of the three SOC reports and the intended replacement for the SAS 70. The majority of insurers using third party administrators should have access to the SOC 1 for these service organizations. The SOC 1 reports provide significant information regarding the internal control environment as it relates to financial reporting at the service organization. A SOC 1 report may be a Type I or Type II report with the Type II being most useful for purposes of financial examinations. Examiners should obtain this report if it is applicable for the insurer under examination.

SOC 2 Report
The SOC 2 report provides reporting options beyond financial controls, covering technology-related areas of primary interest to service providers and user entities such as security, availability, processing integrity, confidentiality and privacy. A few examples of when SOC 2 would likely be beneficial include when the insurer under examination is using a service provider for:

- Cloud computing services
- Call center services
- Sales force automation

As with SOC 1, the SOC 2 report may be either a Type I or Type II report with the Type II being more useful for financial examinations.

SOC 3 Report
The SOC 3 report is the least relevant SOC report in regard to audits and examinations. It is not expected that the SOC 3 report would be obtained during the course of an examination.

Type I SOC
Type I reports could be helpful in providing a sufficient understanding to plan the audit of the user organization. Such a report, however, is not intended to provide any evidence of the operating effectiveness of the relevant controls that would allow the user auditor to reduce the assessed level of control risk. Since no tests were performed on the controls, no reliance can be placed on a Type I report, and therefore, will not satisfy the needs of external auditors or state regulators.

Type II SOC
The Type II report is the report that should be requested and obtained by state regulators. Since testing of controls has been performed, state regulators may decide to place reliance on the report and reduce testing of internal controls. It should be noted that the state regulator remains responsible for evaluating the evidence presented by the service auditor and for determining its effect on the assessment of control risk at the service organization. The user auditor's assessment of control risk is based on the combined evidence provided by the service auditor's report and the user auditor's own procedures.

User Control Considerations (UCCs)
Examiners should review the User Control Considerations (UCCs) within the SOC report carefully. In order for the controls reviewed within the SOC report to be reliable, the examiner must ensure that the UCCs noted in the SOC report are in place and operating at the user organization (the insurer).

Other Considerations
Examiners should note that, because the report may be intended to satisfy the needs of several different user auditors, a user auditor should determine whether the specific tests of controls and results in the SOC report are relevant to assertions that are significant in the user organization's financial statements. Furthermore, examiners should consider whether exceptions identified by the service auditor will affect reliance upon those controls.

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Contact with the servicing entity's auditor may be necessary to better understand the scope and results of the auditor's work. If necessary, the examiner may need to contact the servicing entity to perform additional work regarding specific controls and/or their effectiveness.

G. Use of Independent Contractors on Multi-State Examinations

When evaluating staffing needs to schedule examinations of domestic insurers licensed in multiple states, state insurance departments may find it necessary to engage an independent contractor. An independent contractor is defined as anyone employed by the state insurance department that is outside of the department's staff. Examples of independent contractors, while not inclusive, are as follows:

- Certified Public Accountants
- Contract Examiners
- Specialists

An insurance department's decision to engage an independent contractor may arise due to, among other things, insufficient examination staff or the need to meet statutory mandates. While the foregoing circumstances may lead an insurance department to contract the services of an independent contractor, the department should consider the long term effects of not maintaining an appropriate level of qualified staff. Maintaining competent examiners on examinations and during interim periods enhances the department's ability to effectively regulate domestic insurers and foreign insurers with substantial state premium writings. Through the examination process, examiners can enhance their knowledge of state laws and regulations, various types of insurance products, investment practices, loss reserving techniques, reinsurance transactions etc., that are useful in effectively and efficiently assessing a domestic company's financial condition and results of operations. This internal expertise is particularly important in handling troubled insurance companies.

The use of independent contractors requires the involvement of the state insurance department in directing and monitoring the work performed by the independent contractor. The oversight of independent contractors is primarily the responsibility of the insurance department's designee.

The role of department designee must be filled by an individual who is certified by the Society of Financial Examiners (SOFE) as a Certified Financial Examiner (CFE), or by an individual who has substantially similar experience, qualifications and background. (Include the details in examination planning memorandum.) This individual must be employed by and conducting work solely on behalf of the State Insurance Department.

Depending on the scope of the engagement and extent of the work performed by the independent contractor, the following standards of examination planning, fieldwork, and examination reports are applicable:

1. Standards of Examination Planning and Field Work

   a. The procedures shall be planned and developed according to the Handbook under the supervision and with the participation of the insurance department's designee. This includes review and approval of the examination planning memorandum, which may also warrant a review of workpapers supporting the conclusions reached therein.

   b. The insurance department's designee shall review and approve significant examination workpapers on a timely basis. This includes, but is not limited to the following:

      - Applicable risk assessment workpapers, including the examination risk tracker (Exhibit CC), prospective risk assessment (Exhibit V), key activity matrices and consideration of critical risk categories (Exhibit DD).
      - Ongoing examination status and explanation of modifications to the approved time budget.

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c. The insurance department's designee shall supervise all significant field work activities, including appropriate review and approval of risks identified and planned procedures prior to beginning Phase 3 and Phase 5.

2. Standards of Examination Conclusions and Reporting

a. The insurance department's designee shall review and approve key solvency monitoring and completion documents on a timely basis, including the summary review memorandum (Exhibit AA) and evidence of interdepartmental communication of significant issues and concerns.
b. The examination results and findings shall be reviewed for reasonableness and sufficiency, and accompanying workpapers shall be reviewed for adequacy of documentation by the insurance department's designee.
c. The report shall be prepared by the insurance department in accordance with the Handbook and departmental policy.
d. The report shall be signed by the examiner-in-charge (EIC). If the EIC is an independent contractor, the report shall also be signed by the insurance department's designee.
e. The insurance department's designee shall complete the general review section of the Review and Approval Summary (Exhibit Q) to ensure an appropriate depth of review has been performed.

3. Use of a CPA on an Agreed-Upon Procedures Engagement

While not very common, the use of a CPA independent contractor in an examination may be accomplished through an "Agreed-Upon Procedures Engagement." (Only CPAs can perform an Agreed-Upon Procedures Engagement.) In addition to meeting the standards of examination planning, fieldwork, and examination reports, the following establishes guidelines for engaging a CPA to perform agreed-upon procedures.

The American Institute of Certified Public Accountants (AICPA) Statement on Standards for Attestation Engagements No. 10, *Attestation Standards: Revision and Recodification* (SSAE No. 10), sets forth the standards and provides guidance to the CPA when performing and reporting on engagements to apply agreed-upon procedures. In an agreed-upon procedures engagement, the CPA performs specific procedures on specific elements, accounts or items of a financial statement and issues a report of findings based on those procedures. The insurance department and the CPA agree upon the procedures to be performed by the CPA that the insurance department believes are appropriate. Therefore, the insurance department assumes all responsibility for the sufficiency of the procedures and the risk that these procedures might be insufficient for their purposes. Because the CPA will only report on the findings of the procedures performed, any conclusions regarding the findings, and disposition thereof, must be made by the department. Additionally, the CPA has no responsibility to determine the differences between the agreed-upon procedures to be performed and the procedures that the CPA would have determined necessary had he/she been engaged to perform another form of engagement, such as an audit under generally accepted auditing standards. The department should review SSAE No. 10, and consider the CPA's professional standards prior to engaging an accounting firm to provide this type of service.

The insurance department must attain certain standards relative to the examination report, planning and field work that are in accordance with the Handbook. These standards relate to the responsibilities of the insurance department and the utility of the examination report in achieving regulatory objectives when engaging a CPA to perform agreed-upon procedures.

4. Conflicts of Interest

Conflicts of interest may occur if an examination of a company is performed by an independent contractor who has a significant relationship with the company, its affiliates, or their management (financial or non-financial) that may impair in fact, or appearance, the independent contractor's independence. To evaluate any such conflicts of interest, the insurance department should request a disclosure letter from the independent contractor regarding their past, present or planned relationships, both financial and non-financial, with the examined company or its affiliates. The disclosure letter should discuss the nature of the services provided by the independent contractor and the amount of fees paid to the CPA by the company over the preceding five years.

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Determining whether a potential conflict of interest exists is a matter of considerable judgment. As independent contractors provide many different types of services (e.g., accounting, auditing, actuarial, management and tax consulting), it will be necessary to evaluate the nature of services provided and the amount of fees involved when determining whether a potential conflict of interest exists.

5. Maintenance of Workpapers

The insurance department should maintain, at a minimum, a complete photocopied set of the CPA's original workpapers.

6. Independent Contractors' Immunity Privileges

When hiring independent contractors to perform all or portions of a state insurance examination, the state insurance department should consider the following items related to the independent contractor's immunity prior to finalizing an agreement.

- Review the NAIC *Model Law on Examinations* (#390), Section 8 to determine if your state has adopted these provisions in its statutes. If your state has not adopted Model #390, confirm if it has adopted similar language which grants immunity to any examiner appointed by a commissioner.
- Determine if there are any relevant court decisions or opinions which hold that an examiner appointed by the commissioner is granted immunity from liability in the performance of his/her duties.
- Verify if independent contractors in your state are required to carry liability insurance coverage for work performed. Determine if your state provides insurance coverage to these independent contractors in the performance of their duties.

7. Controlling Exam Costs when Utilizing Independent Contractors

It is important to keep in mind that the use of independent contractors can lead to higher examination costs. It is the regulator's responsibility to appoint and monitor the independent contractor, and it is the insurer's responsibility to cooperate with the independent contractor and provide appropriate input to facilitate an efficient examination process. The insurer may provide factual input to the regulator based on observations of the independent contractor's work. High-level company monitoring of the examination process and ongoing two-way communication of problems on the examination (related to the cooperation of the insurer or the performance of the examination) can help ensure the effective use of independent contractors. If state legislation permits and circumstances are warranted, it may benefit the regulator to consider the following procurement procedures in order to control costs when retaining an independent contractor.

a. The regulator should have minimum qualification standards that the independent contractor should meet in order to be considered in the procurement process. The independent contractor should have the following:

- Practical experience with the type of work that is out for bid;
- Qualified personnel; and
- Demonstrable success on prior contract examinations.

b. The regulator should consider having a meeting with all qualified vendors (independent contractors) and the insurer to further explain, clarify, or identify areas of concern. This meeting should address the following:

- A detailed description/specification of the work to be performed in terms of required outcomes. Specifications should be written to encourage, not discourage, competition consistent with seeking overall economy for the purpose intended. The goal is to invite maximum reasonable competition;
- Concerns of the insurer, independent contractor and the department of insurance; and
- Time frame of the bidding process.

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c. The potential independent contractor should describe their organizational and staff experience as well as past experience, which should be described in sufficient detail to demonstrate their ability to perform the functions outlined by the department. For long-term projects, the independent contractor should document their experience, capability, and commitment to perform project management functions.

d. The independent contractor should provide a minimum of three references who may be contacted where services similar in scope to the requirements outlined by the department have been provided. The state department should consider the independent contractor's experience with other state insurance departments.

e. Prior to selecting the independent contractor, the regulator should consider at least three competitive bids.

f. The most responsive and responsible independent contractor whose bid reflects the lowest price should be considered. "Responsible" means that the vendor has the capability, integrity and reliability to provide the services needed. Being "responsive" means that the bid conforms in all material respects to the requirements outlined by the department.

Various types of contracts exist and each type of contract should be considered by the regulator when utilizing independent contractors. Fixed fee contacts and cost-reimbursement type contracts are two common types of contracts. Fixed fee contracts are contracts for a set amount, regardless of the expenses or hours incurred by the independent contractor. Under this scenario, the independent contractor is fully responsible for performance costs and enjoys (or suffers) resulting profits (or losses) based on the efficiency and effectiveness of their examination progress. Fixed fee contracts are typically appropriate when the work to be performed by the independent contractor can be described clearly and the regulator can provide clear and detailed specifications for how the work is to be done. If a fixed fee contract is not chosen, the regulator may use a cost-reimbursement type contract. In this type of contract, the department agrees to compensate the independent contractor at a fixed hourly rate plus compensation for reimbursable expenses. If this type of contract is used, the regulator should strongly consider making it a three-party contract between the state department, the independent contractor and the insurer.

If a fixed fee contract is used, independent contractor travel expenses are irrelevant to the regulator. If a contract that allows for cost reimbursement is utilized, the regulator should consider the extent of the independent contractor's travel expenses. It is recommended that the regulator monitor the independent contractor's travel expenses. The regulator should consider the recommended per diem rates for lodging, meals and incidentals set forth within Section 1, Part II, D of this Handbook (this is also available on the NAIC Web site).

The above mentioned guidance, as it relates to procurement, contracts and travel expenses, combined with continued monitoring of the independent contractor's work may result in significant cost decreases. It is encouraged that the time budget be communicated to the insurer, however, final approval of the budget should reside with the insurance department and the work of the independent contractor should be directed by the state regulator. Consider holding frequent status meetings with the independent contractor to ensure that the adequacy and timeliness of the work being performed is meeting the department's expectations. The development of a detailed time budget for the independent contractor will allow the insurance department and the insurer to compare the actual work performed with expectations. The time budget should estimate the time to complete examination sections, which typically are annual statement line items, system processes, related controls or the company background. The independent contractor should submit time budgets to the state insurance department on at least a monthly basis, or as often as a detailed time and expense billing report is required to be submitted. The detailed time budget should also include an estimated date of completion for all fieldwork. If any action, or lack of action, by the insurer causes the independent contractor's hours to significantly increase (i.e., a greater than 10% increase in the budgeted time for a specific examination area), the independent contractor should immediately communicate this to the state department, who would then contact the insurer. This same communication process should take place if the independent contractor becomes aware of any material transactions that took place subsequent to the balance sheet date.

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H. Considerations for Insurers in Run-Off

Run-off may be either a voluntary or state mandated course of action where the insurer ceases writing new policies on a portion of business or all business written. During run-off, the insurer typically continues collecting premiums on mandatory policies for a statutorily mandated period and to policy expiration dates. The degree and timing of the reduction in premiums should be closely monitored through projections, which are often provided within a run-off plan. The run off of claims becomes the focus of attention until the last dollar of exposure is paid. The risk exposures for insurers in run-off are likely to be different than that of an insurer writing new business; therefore it may be necessary for an examiner to narrow the focus of the financial condition examination and ongoing solvency oversight of the insurer. For example, when examining a company in run-off, the examiner may be able to reduce testing performed in traditional areas, such as underwriting. The focus of the examination of a run-off insurer may include, but not be limited to, the following:

Run-off Plan

A company in run-off will typically prepare a run-off plan outlining how it will manage its resources in this stage of its operations. The specific content of the run-off plan may vary depending upon the line and nature of business in run-off and the financial condition of the insurer. If the company has prepared a run-off plan, the examiner should obtain the plan and gain an understanding of the process the company has chosen for winding down its business and the primary risks that remain. In addition, the examiner should track the company's progress against its plan to assist in evaluating the effectiveness of the run-off. If the company has entered into run-off since the prior exam, the department analyst may have already obtained the run-off plan. Therefore, the examiner should consult with the analyst prior to requesting the run-off plan from the company.

Corporate Governance

Insurers in run-off are faced with unique challenges in maintaining effective oversight and staffing in circumstances of decreasing resources. Some areas of corporate governance that may be more critical for an insurer in run-off include employee compensation and retention, succession planning, and adequate oversight of critical functions by the Board of Directors and senior management. Evaluating the suitability of key management becomes of increased importance in an environment of high turnover and changing responsibilities. The examiner may also consider whether the company's decreasing resources create segregation of duties issues that limit the effectiveness of the company's internal control structure.

Capital and Liquidity Management

An objective of an insurer in run-off is to manage its assets and liabilities and maintain sufficient cash flow to ensure claim payments are met. Ideally, the insurer will reduce liabilities over time while ensuring its balance sheet maintains liquid assets to pay claims. When assessing liquidity and surplus adequacy, the examiner should evaluate the appropriateness of the insurer's investment portfolio, including proper asset/liability matching. An insurer in run-off would generally be expected to maintain a conservative strategy in order to preserve the ability of invested assets to meet run-off obligations. An aggressive strategy may warrant additional scrutiny by the examiner. The examiner may also evaluate whether the insurer has performed analyses to determine further cash flow needs and stress testing to assess its capital needs. In some circumstances, the examiner may consider involving an actuarial specialist to assist in evaluating the adequacy of the insurer's capital.

Loss and Loss Adjustment Expense (LAE) Reserves

Loss reserves are the largest liability reported by an insurer and one of the most critical pieces of data in assessing an insurer that has entered run-off. Many run-off insurers are thinly capitalized. Given the materiality of this liability, a slight variance in reserves can have a significant impact on the insurer's ability to continue as a going concern. As a result, there is increased importance placed on highly accurate reserve estimations as well as close monitoring of loss reserves. When examining an insurer in run-off, the examiner should consider focusing procedures on the company's processes for determining loss reserves, reviewing loss reserve development trends, and involving an actuarial specialist in evaluating the overall adequacy of the reserves held.

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I. Considerations for Potentially Troubled Insurance Companies

A troubled insurance company is broadly defined as an insurance company that is either in or is moving towards a financial position that subjects its policyholders, claimants and other creditors to greater-than-normal financial risk, including the possibility that the company may not maintain compliance with the applicable statutory capital and/or surplus requirements (*Troubled Insurance Company Handbook*). The "Prioritization Framework" as discussed in the NAIC's *Financial Analysis Handbook* identifies troubled companies as Priority 1.

The *Troubled Insurance Company Handbook* provides a number of insights to assist in enhancing a state's monitoring and surveillance, and it outlines several regulatory actions available to Departments of Insurance (DOIs). In situations in which an examination is being planned for a troubled insurance company (i.e., Priority 1 company), the NAIC's *Accreditation Program Manual* (Part B3: Department Procedures and Oversight) indicates that "the Department should generally follow and observe procedures set forth in the NAIC *Troubled Insurance Company Handbook.*" However, regulators may also consider leveraging the insights in the *Troubled Insurance Company Handbook* for Priority 2 companies, which are defined in the *Financial Analysis Handbook* as "high-priority insurers that are not yet considered troubled, but may become so if recent trends or unfavorable metrics are not addressed."

J. Comments and Grievance Procedures Regarding Compliance with Examination Standards

This section covers procedures to be followed by industry and regulators relating to comments and grievances involving compliance with examination standards.

Each comment or grievance must be put in writing and presented in the following format. The matter is to be addressed to the Examination Oversight (E) Task Force.

The resolution of each submission either will be made or administered by the Task Force with ratification by the parent committee of the NAIC. Subsequent to ratification of action taken, the person making the submission will be notified.

The above procedure should suffice to receive and properly respond to any and all matters involving compliance with examination standards.

COMPLIANCE WITH EXAMINATION STANDARDS

COMMENTS AND GRIEVANCES

Date:

To: Chair, Examination Oversight (E) Task Force

From:

Nature of Comment and/or Grievance and Proposed Method for Resolution, if any. (Please submit complete particulars together with any references, etc.

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IV. STANDARD EXAMINATION PROCEDURES

Certain general procedures should be considered on all full-scope examinations. The examination program should include a section that explains the nature and extent of these general examination procedures. Automation tools are recommended when conducting examinations to ensure more efficient examinations. This part of the Handbook addresses the following subjects, which are applicable to most examinations:

A. Examiner Request Log
B. Examination Documentation
C. Review of General Ledger and Journal Entries
D. Related Party/Holding Company Considerations
E. Consideration of Fraud
F. Examination Review Responsibilities
G. Letter of Representations
H. Review of Subsequent Events
I. Review of Premium Taxes
J. Summary of Unadjusted Errors

A. Examiner Request Log

The company's timely cooperation in the examination process is essential to performing an efficient examination. Lack of cooperation by the company can dramatically increase the cost of the examination. Delays in providing information or inadequate/incomplete information provided to the examiner are common issues experienced by examiners. To assist in tracking information requests made of the company, the examiner may want to consider utilizing an examiner request log to proactively monitor the timeliness of company responses and keep the company and the insurance department informed of any problems encountered as it relates to information requests.

B. Examination Documentation

The examiner must prepare examination documentation for each exam in sufficient detail to provide a clear understanding of the work performed, the exam evidence obtained and its source, and the conclusions reached. Examination workpapers should include:

- A title, which includes the name of the insurer, a title or description of the workpaper and its contents and the effective date of the financial statements under examination.
- A procedure, describing the purpose of the workpaper with descriptions of the tests to be performed.
- A source, noting where the information provided and tested on the workpaper was obtained from.
- A conclusion regarding the results of the examination testing and the conclusions that can be reached from those results.
- A preparer sign-off, noting the date the work was completed.
- A reviewer sign-off, noting the date the work was reviewed.

Examination documentation may include, but is not limited to, exam programs, analyses, issues memoranda, summaries of significant findings or issues, letters of confirmation and representation, checklists, abstracts or copies of important documents, correspondence (including e-mail) concerning significant findings or issues, and schedules of the work the examiner performed.

Abstracts or copies of the entity's records (for example, significant and specific contracts and agreements) may be included as part of the examination documentation if they are needed to support the work performed and conclusions reached. Any information provided by the client should be marked as such. Oral explanations on their own are not sufficient support for documenting exam evidence or reaching conclusions, but may be used by the examiner to clarify or explain information contained in the examination documentation.

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In conclusion, the examiner should prepare examination documentation that enables the reviewer to understand:

- The nature, timing, and extent of examination procedures performed to comply with examination standards and applicable legal and regulatory requirements.
- The expectations and results of the examination procedures performed and the evidence obtained.
- The conclusions reached on significant matters.
- That the insurer records agree or reconcile with the examination financial statements or other examination information.

C. Review of General Ledger and Journal Entries

The examination team should review the general ledger, significant nonstandard journal entries, and any company workpaper entries made solely to prepare the annual financial statement. As this procedure is often performed by external auditors in conjunction with the annual financial statement audit, the examination team should consider utilizing existing work in this area when possible. Before placing reliance upon such work, the examination team should consider the results of Exhibit E – Audit Review Procedures. The purpose of this review is to identify any significant or unusual postings from unfamiliar sources, and other unusual entries that might not have been identified through other audit procedures (e.g., the purchase and sale of a significant block of business in the same year).

In accordance with the risk focused approach, the examiner should also:

- Gain an understanding of the entities financial reporting process and controls over journal entries and other adjustments.
- Identify and select journal entries and other adjustments for testing.
- Determine the timing of the testing.
- Inquire of individuals involved in the financial reporting process about inappropriate or unusual activity relating to the processing of journal entries or other adjustments.

This review should be performed by an individual sufficiently familiar with the recurring journal entries and other posting sources so that unusual items will be detected. The examiner should consider using computer assisted audit tools (CAAT) to perform journal entry testwork in order to focus on high risk journal entries as determined by the computer analysis rather than simply taking a sample from the entire set of journal entries.

According to AU Sec. 316, fraudulent adjustments often have certain unique identifying characteristics. Such characteristics may include entries (a) made to unrelated, unusual or seldom-used accounts; (b) made by individuals who typically do not make journal entries; (c) recorded at the end of the period or as post-closing entries that have little or no explanation or description; (d) made either before or during the preparation of the financial statements that do not have account numbers; (e) contain round numbers or a consistent ending number; (f) applied to accounts that contain transactions that are complex or unusual in nature, contain significant estimates and period-end adjustments, have been prone to errors in the past, have not been reconciled in a timely basis or contain unreconciled differences, contain inter-company transactions, or are otherwise associated with an identified risk of material misstatement due to fraud.

Examiners should consider this guidance, along with other materiality and risk factors, when selecting journal entries for review.

D. Related Party/Holding Company Considerations

As insurance holding companies grow in complexity, related parties often represent a significant area of risk for insurance companies under exam. Risks may arise from transactions and agreements arising from relationships with affiliates that affect the insurer's ongoing solvency position. Risks may also originate from inequitable contract provisions, the impact of guarantees, contagion risks extending from holding company operations, intercompany tax issues, etc. Consistent with other complex areas of an exam, it is important that the examiner leverage analyst insights when deciding upon group risks that have a potential solvency impact on the legal entity under exam. As the examination process is generally legal-

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entity focused, the exam team should limit its review of group issues to those with the potential to significantly impact the solvency position of the insurer(s) under examination. The narrative that follows will help examiners understand the risks that related parties may pose insurance companies both in relation risks that originate from transactions as well as risks that stem from the relationship between the related party entities.

General Related Party Considerations

The following list provides an approach for detecting abuses that sometimes result from holding company or affiliated relationships:

Potential abuses:

(1) Misuse of insurance company assets through:

- Shifting assets (particularly securities) from one affiliate to another for "window dressing" purposes during examinations or at the financial statement date.
- Making unsecured loans or advances to affiliates.
- Maintaining compensating bank balances for the benefit of an affiliate.
- Making inappropriate loans to affiliates or purchases of affiliate securities.
- Pledging assets to secure loans for affiliates.

(2) Siphoning of insurance company funds through:

- Dividends.
- Management or service fees.
- Payment of exorbitant reinsurance premiums to affiliates.
- Inappropriate payment of the expense of affiliates.
- Misdirection of premiums or commissions to affiliate insurance companies or agencies.

(3) Other forms of misrepresentation:

- Creating nonexistent receivables due from affiliates for "window-dressing" purposes during examination or at the financial statement date.
- Assuming the liabilities by/for an affiliate.

Moreover, related parties may present risks to the legal entities beyond misuse of assets, siphoning of funds or misrepresentation. Related parties (especially those with common ownership) often devise strategy as a joint effort. Therefore, one related party experiences financial or operational difficulty, it may impact the reputation or even the strategy of other companies in the group. Given the complexity of these sorts of risks, examiners typically identify relevant areas of risk in this are through discussion with the department's financial analyst.

Work performed related to related party transactions should be dependent on the insurer's exposure to risk in this area. If, after understanding the various relationships and transactions during the planning process, the examiner deems related parties to be an area of risk exposure, additional testing in subsequent phases of the examination should be considered. The examiner may utilize the sample risks provided in the Related Party Examination Repository to address risks in this area and to ensure an appropriate review of the Related Party/Holding Company Considerations critical risk category is conducted. Additionally, upon completion of examination planning, the examiner should document any significant agreements, transactions and/or findings in the examination planning memo. Inclusion of an item in the company's letter of representation may also be warranted to confirm management's identification and disclosure of related party transactions to the examination team.

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Related Party Transactions

This section provides guidance for identifying and examining related party transactions. There are two broad categories of related party transactions:

- Transactions having implications as to potentially misleading the presentation of the Annual Statement. Such transactions frequently have involved questionable dealings, including management fraud. This type of related party transaction occurs infrequently, but constitutes a difficult area.
- Transactions occurring in the ordinary course of business are considered related party transactions only because of an existing relationship between the transacting parties.

Generally, examiners are more concerned with detecting and disclosing the related party transactions in the first category than with the related party transactions that are transacted in the ordinary course of business. Even though the greatest exposure is focused on only a relatively few related party transactions, procedures are performed to encompass the broad definitions of related party and related party transactions. Additional considerations for related party transactions can be found in the Examination Repository – Related Party located in Section 3 of this Handbook. Regulators should also be sure that risks identified address the associated Critical Risk Category (Related Party/Holding Company Considerations) as reflected in Exhibit DD.

A related party transaction is any direct or indirect transaction between the reporting entity and an affiliate. Affiliates exist when there is a relationship that offers the potential for self-dealing transactions at less than arm's length, favorable treatment, or the ability to direct the outcome of events differently from what might result in the absence of that relationship. Related party transactions include transactions between:

(1) A parent company and its subsidiaries.

(2) Subsidiaries of a common parent.

(3) The reporting entity and:

- Other affiliated businesses.
- Management (including directors).
- Principal owners.
- Pension and profit-sharing trusts managed by or under the trusteeship of management.
- Entities for which investments are accounted for by the equity method.

An affiliate also includes any other person with which the reporting entity might deal if one party controls or can significantly influence the management or operating policies of the other to an extent that one of the transacting parties might be prevented from fully pursuing its own separate interests. SSAP 97 – Investments in Subsidiary, Controlled, and Affiliated Entities states that "control presumed to exist if a reporting entity and its affiliates directly or indirectly, own, control, hold with the power to vote, or hold proxies representing 10% or more of the voting interests of the entity." A third person also is affiliated if it can significantly influence the management or operating policies of the transacting parties or if it has an ownership interest in one of the transacting parties and can significantly influence the other to an extent that one or more of the transacting parties might be prevented from fully pursuing its own separate interests.

Related party transactions also could include other transactions in which the reporting entity may not appear to be involved. Identifying these related party transactions is frequently difficult, if not impossible, because (1) examiners ordinarily must rely on oral representations to obtain an awareness that a relationship exists and a transaction has occurred; and (2) the parties to the transaction may be averse to disclosing the motives, facts and circumstances surrounding the transaction.

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Transactions that, after study, cannot be understood as to their apparent motivation or appear to be commercially unreasonable raise the presumption that a related party transaction exists. Where subtle affiliated relationships are known or believed to exist, examiners should perform procedures to determine whether a related party transaction classification is appropriate. Although oral representations of management or others often are required to understand the business purpose of the transaction, such representations should be evaluated in light of apparent motives and the weight of other evidence. Important oral representations should be confirmed in writing, either in the letter of representations or in a separate letter.

There are a number of conditions that might create motivation for related party transactions that are designed to alleviate or forestall circumstances management perceived would adversely affect the company. Some examples are:

- Lack of sufficient surplus to continue the business.
- An urgent desire for a continued favorable earnings record in the hope of supporting the price of the company's stock.
- An overly optimistic earnings forecast.
- Dependence on a single, or relatively few, products for the ongoing success of the company.
- Significant litigation, especially between shareholders and management.

Absent contrary circumstances, transactions with affiliates should not be assumed to be outside the ordinary course of business. However, related party transactions are occasionally deliberately obscured by using devices such as business structure or management operating style.

Circumstances such as these should increase the examiner's skepticism of management. These circumstances might illustrate a management team determined to attain its objectives, regardless of the means required to do so.

If the transaction is recurring, there should be a contract/agreement in place and it is required to be filed with the department under the NAIC's Insurance *Holding Company System Model Regulation* (#450). Additional insight, including provisions the regulator can consider are included in Section I-III (F) Outsourcing of Critical Functions, under the "Affiliated Service Providers" heading.

Related party Transactions with Partial or No Accounting Recognition

Transactions by or among affiliates are considered to be related party transactions s, even though they might be given partial or no accounting recognition. For example, an entity that provides significant services to an affiliate without charge, or at charges that do not approximate might be involved in a related party transaction.

Related Parties without Transaction

Sometimes two or more entities are under common ownership or management control, but do not transact business between or among themselves. The mere existence of common control may result in operating results or a financial position significantly different from what would have occurred if the entities were autonomous. For example, two or more entities in the same line of business may be commonly controlled by a party with the ability to increase or decrease the volume of business done by each (i.e., the ability to exercise significant influence over the operations of each entity).

One means used by many entities to preclude significant affiliate influence is to prohibit a director or other member of management from voting, or otherwise participating, in any business decisions in which that individual is an affiliate. In some cases, the affiliate might have participated in a business decision and it might not be practical for the board to reconsider a previously approved transaction solely so that person can abstain from voting. In these instances, it usually is acceptable to obtain written representation from appropriate management and the affiliate that significant influence was not exercised, provided that by reference to the entity's minutes or otherwise, the examiners are able to satisfy themselves that the affiliate's vote did not influence the outcome of the board's decision (e.g., the resolution was unanimously approved). If examiners are unable to satisfy themselves as to the absence of significant influence, or if they otherwise

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conclude that a relationship or transaction merits the attention of the board of directors, they may recommend subsequent reconsideration of an issue by the board of directors, with any affiliates required to abstain from voting.

Work performed related to related party transactions should be dependent on the insurer's exposure to risk in this area. If, after understanding the various relationships and transactions during the planning process, the examiner deems related parties to be an area of risk exposure, additional testing in subsequent phases of the examination should be considered. The examiner may utilize the sample risks provided in the Related Party Examination Repository to address risks in this area and to ensure an appropriate review of the Related Party/Holding Company Considerations critical risk category is conducted. Additionally, upon completion of examination planning, the examiner should document any significant agreements, transactions and/or findings in the examination planning memo. Inclusion of an item in the company's letter of representation may also be warranted to confirm management's identification and disclosure of related party transactions to the examination team.

E. Consideration of Fraud

Examiners should consider the impact and possibility of fraudulent activity while conducting financial condition examinations. In order to effectively complete this task, the examiner should obtain and review the documentation provided by the independent CPA that illustrates their consideration of fraudulent activity. In addition, the examiners should perform a preliminary fraud risk assessment in order to obtain reasonable assurance that the financial statements do not contain misstatements due to fraud. Exhibit G – Consideration of Fraud, included in this Handbook, may be used for conducting and documenting fraud risk factors, as well as the overall consideration of fraud.

The examiner should consider the risk of fraud for fraudulent company reporting and fraudulent claims incurred by the company. If applicable, based on the offering of covered products, the examiner should also consider the insurer's anti-money laundering program and its ability to detect, monitor, and report suspicious activity, in an effort to prevent the company from being used to facilitate money laundering or the financing of terrorist activities.

a. Fraudulent Company Reporting – Occurs as a misstatement, or omission of amounts or disclosures, in the financial statements (fraudulent financial reporting) or with the theft of assets (misappropriation of assets) that results in the financial statements being improperly stated. Fraudulent company reporting is instigated within a company. It is important for the examiner to understand the controls established within a company to determine whether proper control procedures and supervisory techniques have been implemented to mitigate the risk of this type of fraud. Although proper control procedures may assist in reducing the risk of this fraud, the risk of fraudulent company reporting can never be totally eliminated, due to collusion and other factors.

b. Fraudulent Claims – Occurs when improper or unsupported insurance claims are submitted to the company. These types of claims are more difficult to identify than fraudulent financial reporting, as they typically occur through the collusion of outside individuals (e.g., claimant and doctor). However, the company should have controls and documentation procedures established for claim processing to mitigate these fraud occurrences. The examiner will want to identify the procedures in place and verify that they are properly being followed. In addition, the examiner will want to ascertain the company's methods to address identified instances of fraudulent activity and those who perpetrate them.

c. Anti-Money Laundering (AML) Program

Background on Companies Qualifying for AML Review

Although the USA PATRIOT Act of 2001(The Act) requires AML programs for all financial institutions, the Act only applies to those insurance companies offering covered products. These products include: (i) A life insurance policy with any type of cash surrender value; (ii) any annuity contract, other than a group annuity contract; and (iii) any other insurance product with features of cash value or investment. In general, the most significant money laundering and terrorist financing risks in the insurance industry are found in life insurance and annuity products because such products allow a customer to place large amounts of funds into the financial system with the potential of transferring those funds to another person/entity, thus, masking their true origin. Each insurance

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company issuing or underwriting a covered product must develop and implement an AML program reasonably designed to prevent the insurance company from being used to facilitate money laundering or the financing of terrorist activities. The insurer does not have to implement a company-wide program but, rather, a program that applies only to the insurer's covered products. Exhibit G provides a detailed checklist of the minimum requirements for the AML program as noted below. The examiner should utilize this checklist when evaluating the company's AML program.

Components of an AML Program

Beyond the minimum requirements discussed below, insurance companies are given the flexibility to design their programs to meet the specific risks associated with their particular business. The program must be in writing, approved by senior management and made available to the U.S. Treasury Department, the Financial Crimes Enforcement Network, or their designee, upon request. The minimum components of the AML program, also known as the "Four Pillars," are as follows:

- The program must incorporate policies and procedures and internal controls based on the insurance company's assessment of the money laundering and terrorist financing risks associated with its covered products. An insurance company's assessment of customer-related information, including method of payment, is a key component of an effective AML program. The company must also implement policies and procedures that enable it to detect, monitor, and report suspicious activity related to potential money laundering and terrorist financing transactions. Thus, an insurance company is responsible for integrating its agents and brokers into its AML program (1) for obtaining relevant customer-related information from them; (2) for using that information to assess the money laundering risks presented by its business; and (3) to identify any "red flags" that may indicate suspicious activity.

- The insurance company must designate a compliance officer to be responsible for implementing and monitoring compliance of its AML program, including the activities of its agents and brokers. The compliance officer must ensure that the program is updated as necessary and that the appropriate persons are educated and trained.

- The insurance company must provide training for appropriate persons. Employees with responsibility under the program must be trained in the requirements of the program, and money laundering risks generally, so that "red flags" for suspicious activity associated with covered products can be identified. A company that offers more complex products may need to offer more comprehensive training programs for employees. Companies should also ensure that their agents are adequately trained on the risks of money laundering and terrorist financing.

- The insurance company must provide for independent testing of the program on a periodic basis to ensure that it complies with the requirements of the rules and that the program functions as designed, including testing to determine compliance by the company's agents and brokers with their obligation under the program.

Examination Procedures Related to AML

A complete AML examination may be conducted by the appropriate, primary federal regulator of the insurance company; therefore, a full-scope AML examination performed by state insurance regulators is unnecessary. However, the financial examination of an insurer issuing covered products should include the following procedures to address anti-money laundering:

- Conduct a brief interview of the compliance officer responsible for implementing and monitoring compliance with the company's AML program. If the compliance officer delegates certain responsibilities to other employees, it may be appropriate to also conduct interviews with them. Topics of the interview should include, although not be limited to, the oversight of the day-to-day compliance with AML

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requirements, the contents of the company's AML program, risk assessment, training program, and independent test plans, and how the company monitors and controls the activity of its agents. The interview should also cover policies and procedures for detecting, monitoring, and reporting suspicious activity. This includes the company's decision making policies for reporting suspicious activity when "red flags" are identified. Finally, the examiner should make sure the company has procedures in place to report Form 8300s for the receipt of cash premium payments in excess of $10,000. An insurance must report a Form 8300 when it (or its agent) receives currency in excess of $10,000 in a single transaction, or two or more related transactions. This only applies to applicants or policyholders who pay for policy premiums with cash. Any significant risks related to money laundering activities should be documented by the examiner to verify they have been addressed in the company's risk assessment. During the interview, the examiner should note if the compliance officer is being less than candid, has provided false or misleading information, appears to lack an understanding of the company's risks of money laundering activities, or has omitted material information related to anti-money laundering that should be disclosed to the Financial Crimes Enforcement Network for further consideration.

- Obtain a copy of the written AML program and verify that it includes the necessary components discussed in the bullets above. Also, verify that the program is approved by senior management.

- Obtain copies of the company's risk assessment, independent test plans and the results of the testing performed and review for any significant issues. Although the AML program must be in writing, insurance companies are not required by regulation to create a written risk assessment. However, management is encouraged to document its risk assessment in writing in order to provide a clear basis for the company's policies and procedures. Examiners should consider whether the company's process for periodically reviewing and updating its risk assessment is adequate. A company's AML program must be commensurate with the risks posed by the size of the particular insurance company, by the nature and volume of the covered products it offers, and by the distribution channels it utilizes to market the covered products. In its risk assessment, each company should identify and assess the money laundering risks that may be associated with its risk categories (i.e., unique combination of covered products, services, customers and their geographic locations, distribution channels, internal controls, etc.). The company should conduct a more detailed analysis of these categories as they apply to the company in order to assess the risk associated with each risk category. The examiner should review the risk assessment for completeness to determine whether management has considered and adequately assessed all the appropriate risk categories. Rationale for the frequency of independent testing should be included in the risk assessment.

Independent Testing: An outside consultant or accountant need not perform the testing. A single employee of the insurance company, or a committee comprised of more than one employee, may perform the independent testing, as long as the tester is not the compliance officer or otherwise involved in administering the program. The primary purpose of the independent testing is to determine the adequacy of the company's AML program, including whether it is operating in compliance with the requirements of the Bank Secrecy Act and the company's own policies and procedures. The scope and quality of the independent review(s) may provide examiners with a sense of particular risks in the insurance company, how these risks are being managed and controlled, and the insurance company's response to identified weaknesses. The independent reviewer's workpapers can assist examiners in understanding the review coverage and the quality and quantity of testing performed.

At a minimum, the independent review should:

1. Provide a fair and unbiased appraisal of each of the required elements of the insurance company's AML program, including its Bank Secrecy Act compliance-related policies, procedures, internal controls, recordkeeping and reporting functions, and training. Internal controls should adequately identify "red flags" for potentially suspicious activity.

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2. Be based on the risks of the company, should test the company's risk assessment for reasonableness, and should determine the adequacy of the risk mitigation strategies in place. The independent review should include testing of internal controls and transaction systems and procedures to identify problems and weaknesses and, if necessary, recommend to management appropriate corrective actions. If automated systems are utilized by the company to detect potentially suspicious activity, the company should have an appropriate understanding of the parameters set to identify "red flags."

3. Include transaction testing to determine if all requirements of the company's AML program have been implemented and if policies, procedures, processes, and internal controls are working appropriately. The independent review should include transaction testing for suspicious activity and Form 8300 reports for the receipt of cash premium payments over $10,000.

4. Cover all of the AML program actions taken by or defined as part of the responsibility of the designated compliance officer. These actions include, for example, the determination of the level of money laundering risk faced by the business, the frequency and adequacy of BSA/AML training for employees and agents, and the adoption of procedures for implementation and oversight of program-related controls and transaction systems.

5. Verify that the company is taking active measures to address any significant deficiencies noted in the independent testing results.

6. Verify that the company is conducting AML training for appropriate personnel and procedures are in place to ensure agents are trained. The company should have records to verify AML training is being conducted and employees and agents have completed the training.

If an examiner identifies any significant issues related to anti-money laundering compliance based on the procedures above or if an insurer has not established an AML program, the examiner should communicate this to the chief examiner for appropriate action including notifying the Financial Crimes Enforcement Network according to its Memorandum of Understanding agreements with the states. Unless the issues discovered above result in a financial solvency concern, state insurance regulators are not expected to perform extensive testing, transactional or otherwise, during their examinations and should defer to the appropriate federal Financial Crimes Enforcement Network for additional consideration. Referrals of significant issues related to anti-money laundering compliance should be sent to:

Financial Crimes Enforcement Network
Office of Compliance and Enforcement
Enforcement Division
Attention: Marsha Hunt, Senior Liaison Officer
P.O. Box 39
Vienna, VA 22183-0039

E-mail: Marsha.Hunt@FinCEN.Gov

The use of fraud risk factors assists the examiners in determining whether fraudulent activity exists. Fraud risk factors are events dealing with management characteristics, industry conditions or the company operating characteristics or financial stability that may indicate an environment for fraud. Fraud risk factors do not indicate that fraud has been perpetrated on or within the company, but they promote the identification of situations or company circumstances that are typically conducive in fraudulent schemes. Typically, fraud occurs when there has been an incentive, opportunity or attitude that permits the occurrence of fraud. Although fraud can occur when only one of these characteristics is present, fraud is most likely to occur when more than one of these conditions is a factor. For example, the more incentives or pressure an employee has to achieve a specific financial statement result, the more likely the employee will be able to rationalize the acceptability of fraudulent activity.

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F. Examination Review Responsibilities

Workpapers are reviewed principally to ensure that the work performed is in accordance with appropriate standards and that the report is appropriate in the circumstances. Other benefits of the review process include the ability to provide members of the professional staff with on-the-job training and to assess their performance.

The review of workpapers is carried out at two distinct levels: detailed and general. Each of these levels of review is intended to accomplish specific objectives. As a result, reviewers at each level have specifically designated responsibilities.

This section sets forth considerations regarding the review of workpapers. It includes guidelines for the nature and extent of the review and the completion of a Review and Approval Summary form.

a. Objectives of Workpaper Review

The review of workpapers is an integral part of complying with appropriate standards. The primary objectives of review procedures are to determine whether:

- The work has been appropriately planned.
- The scope of work is sufficient to support the findings or conclusions contained in the report.
- The work has been performed in accordance with the standards of the insurance department and the NAIC.
- The examination report is supported by the work performed as documented in the examination workpapers.

In addition to these primary objectives, the review also allows the assessment of individual performance, provides on-the-job training and evaluates the progress of the examination. The goal should be to perform as much of the review as possible in the field and before the completion of field work.

b. Levels of Review

To accomplish the review objectives, two categories of review procedures have been established. The detailed review covers the technical accuracy and completeness of the workpapers. A detailed review of each work area should be performed by the examiner-in-charge. In larger examinations, detailed review responsibilities may be shared by two or more people. The general review focuses on the adequacy of the work as a whole. This review should be performed by the chief examiner, or designee.

c. Review of Planning Workpapers

Before any significant work begins, a detailed review of the planning workpapers and examination program should be performed by someone at a level higher than the preparer.

On some examinations, it may not be practical to perform the detailed review of the planning workpapers for all areas before work in Phase 3 begins. In these cases, where one key activity is ready to proceed before all planning work is complete, the planning work impacting that particular key activity should be reviewed prior to substantial examination procedures being performed in that area.

Involvement by experienced examiners in planning meetings and in early review of the documentation of the planning effort will enhance the efficiency of the examination. The chief examiner, or designee, should approve the Examination Planning Memorandum before significant testwork begins.

The chief examiner, or designee, also should approve on a timely basis the staffing plan, time budget and assignment of the detailed review responsibilities, taking into consideration the level of risk associated with the various work areas.

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d. Detailed Review

All workpapers require a detailed review. On larger examinations, there may be two or more detailed reviewers, each with responsibilities for particular areas. On smaller examinations, typically there will be only one detailed reviewer.

The completion of the risk assessment enables examiners to plan the review to be proportionate to the risk of material error in specific accounts and transactions. This risk of material error and the technical competence and experience of the assigned staff personnel will influence who should perform the procedures in each area. These same factors should influence the selection of the detailed reviewer for each area.

For example, an examiner-in-charge ordinarily will perform procedures in areas requiring significant subjective judgments. As a result, the chief examiner, or designee, would perform a detailed review of the work in these areas.

The emphasis of a detailed review is on the technical accuracy and completeness of the workpapers. A detailed reviewer should determine whether:

- Procedures in the examination program were properly performed. These procedures should be cross-referenced from the examination program to the workpapers where the work is evidenced.
- Conclusions are clearly documented and adequately supported by the workpapers. A detailed reviewer should determine whether all tick marks are clearly explained, all significant or unusual amounts are appropriately supported and explained, and any ambiguous comments are clarified or removed.
- Procedures performed were sufficient in light of the examination findings and any changes in conditions occurring since the procedures were planned. The examination program is developed from expectations based on conditions existing during the planning process. Therefore, examiners should evaluate the results of procedures against those expectations, considering any subsequent changes in conditions.

In connection with the detailed review, the examiner should complete Exhibit AA – Summary Review Memorandum (SRM), or a substantially similar document.

e. General Review

The general review, which focuses on the adequacy of the examination work as a whole, should be performed by the chief examiner, or designee. The general reviewer's responsibilities are to determine whether:

- An adequate detailed review has been performed for all work areas. If any workpapers have not had a detailed review, the general reviewer should perform the review or see that it is done.
- The examination has been performed in accordance with this Handbook.
- Business processes relating to significant financial reporting and prospective solvency risks have been adequately reviewed and concluded upon.
- The SRM covers all important examination issues (see Exhibit AA for additional guidance).

The general reviewer's responsibilities may be fulfilled without reviewing all workpapers. This means that workpapers relating to low-risk areas ordinarily need only be scanned, while other workpapers should be read more closely. Duplication of the work of the detailed reviewer should be avoided, except to the extent considered necessary to evaluate the adequacy of the detailed review. The extent of the general review is a matter of judgment and will vary among examinations. Ordinarily, the direction and extent of the general review will be influenced by the following:

- Inherent and residual risk assessments within the risk assessment workpapers.
- Items covered in the SRM.
- Technical competence and experience of the personnel who performed the work and completed the detailed review.

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The general review should include the workpapers relating to important examination issues. Typically, such workpapers should document the following:

- Complex or unusual transactions, including affiliated transactions.
- Areas where problems were encountered, whether expected or unexpected.
- Changes in accounting policies.

The general reviewer should be satisfied that the annual statement review procedures as described below have been performed. The final overall review of the Annual Statement may indicate a need for the general reviewer to focus on particular workpapers to understand the reasons for fluctuations or unusual relationships.

f. Actuarial Review

The workpapers or supporting documentation of the actuarial examiner or consulting actuary should also be reviewed. Those performing this review could include the examiner-in-charge, chief examiner or insurance department actuary.

g. Annual Statement Review Procedures

Examiners should perform a final overall review of the comparative annual statements near the conclusion of field work. The purpose is to ensure that (1) the numbers make sense in light of the understanding of the company; and (2) satisfaction with the sufficiency of the examination procedures.

h. Documentation of Review

Reviewers should document their review by signing or initialing and dating each workpaper. General reviewers should sign or initial workpapers they have read, but need not document their review of workpapers they have merely scanned to determine whether previous reviews were performed adequately. If there are several workpapers comprising one account analysis or documenting one procedure, it is sufficient to sign or initial and date the first page only. Reviewers also are encouraged to add their own explanations or rationale in support of conclusions to the workpapers they review.

i. Review and Approval Summary

The Review and Approval Summary (RAS) for financial examinations is applicable to all examinations. Completion of this form documents the performance of the review requirements of this part.

It is the responsibility of the chief examiner, or designee, to be satisfied that all required review procedures are performed and are documented before authorizing the release of the report. An example of such documentation is included in Exhibit Q – Review and Approval Summary (RAS) for Examinations.

j. Examiner's Affidavit

After performing a detailed review of all examination workpapers, it is the responsibility of the examiner-in-charge to be satisfied that the examination was performed in a manner consistent with the standards and procedures required by the domiciliary state. An example of such documentation is included in Exhibit S – Examiner's Affidavit as to Standards and Procedures Used in an Examination.

G. Letter of Representations

a. Reliance on Management Representations

During the course of an examination, a company's management makes many representations to examiners in response to specific inquiries and through the financial statements. Management representations, either oral or

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written, generally should not be taken as the only support for important examination judgments and conclusions. These representations should corroborate information obtained from applying other examination procedures. In certain situations, however, corroborating information that can be obtained from applying examination procedures other than inquiry are limited. For example, when a company plans to take future action that has an impact on the annual statement under examination, the expression of that intention might be the only evidence available. In these situations, a written representation should be obtained to confirm management's plans.

b. Obtaining the Letter

As part of every examination, a letter of representation should be obtained from management. The representations included in such a letter are management's statements obtained to provide evidence, avoid misunderstanding and secure the active cooperation of the company in the performance of procedures. A sample letter is included within Exhibit T – Sample Letter of Representation.

The sample letter includes typical language that may apply to property/casualty and/or life/health insurance companies, title companies and mortgage guaranty insurers, as well as health maintenance organizations. The actual letter of representation used in a particular examination should be tailored for the company under examination based on the facts and circumstances surrounding that examination. The examiner should be alert for areas of significance that should be included in the company's letter, in addition to those provided in the sample letters. Conversely, many of the items included in the sample letters will not be applicable to the company under examination and should be omitted from the actual letter of representation used for that examination. In general, such letters are no more than a few pages in length, confirming in broad terms the significant representations of management.

c. Signing and Dating Requirements

Letters of representation should bear the same date as the examination report and should be signed by the company's chief executive, financial and accounting officers. Other officers and employees whose functions include significant responsibility for the financial reporting process also should be asked to sign the letter.

d. Review with Management

For convenience, a letter of representation usually is drafted by the examiner and given to the company's management for signature. As a matter of courtesy, and for letters to accomplish their purpose, the representations should be discussed with the individuals who will be asked to sign the letter. Making a draft of the letter available for management's review well ahead of the completion of the examination generally facilitates management's understanding of the purpose and content of the letter and will allow the examiner to obtain the required signatures on a timely basis.

H. Review of Subsequent Events

Some events or transactions that occur after the balance sheet date may have an important bearing on the financial statements. If it is determined that a subsequent event is material to the financial statements, the examiner should consider whether the condition existed: (1) at the balance sheet date; (2) after the balance sheet date but prior to the issuance of the financial statements; or (3) after the balance sheet date and subsequent to the issuance of the financial statements.

For those subsequent events that provide additional evidence about conditions that existed at the balance sheet date that are not reflected in the values reported in the financial statements, an examination adjustment should be made by the examiner.

For those subsequent events that provide evidence about conditions that did not exist at the date of the balance sheet but developed prior to the issuance of the insurer's financial statements, a footnote disclosure is not required; however, if the undisclosed subsequent event could make the financial statements misleading, a description of the event and an estimate of the financial effect of the subsequent event should be disclosed in the footnotes to the examination report. The same

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treatment should be used for subsequent events where no evidence of the condition existed until after the insurer's financial statements were issued. No examination adjustments would be required in these situations since the condition did not exist at the balance sheet date. As long as the insurer used sound judgment at the time of the issuance of the financial statements regarding the subsequent event, the future condition should not be used to determine the values at the "as of" date on the balance sheet.

In connection with the review of subsequent events, the examiner should complete Exhibit P – Review of Events Subsequent to the Exam Period, which contains specific procedures related to the review for, and identification of, subsequent events.

I. Review of Premium Taxes

Due to significant compliance issues associated with, and in many cases, the materiality of premium taxes paid by an insurer, the examiner should review the proper allocation of premium amounts by line of business, and the proper calculation and remittance of premium taxes for all examinations of multi-state insurers. Lines of control and detail test procedures that may be performed to gather sufficient evidence that an insurer has properly reported the allocation of premium amounts and calculated and remitted its premium tax payment can be found in the Examination Repository – Online Supplement, located on the NAIC Web site.

It should be noted that certain procedures may already be performed by taxing authorities and, based upon the extent of the procedures performed by the taxing authorities, may be considered duplicative and unnecessary for the exam team to review.

J. Summary of Unadjusted Errors

Errors detected as a result of substantive testing may take many forms, including both known and likely errors as demonstrated in the PPS sampling discussion. In addition to these, examiners may note classification errors or have disagreements with an insurance company's management regarding various accounting estimates used by the company.

One of the objectives of the examiner is to determine whether the company's surplus or solvency position is materially misstated. Frequently, the examiner adjusts for the error within his or her examination report. In addition, examiners may also encounter individually small misstatements that are not considered material to the company and are so insignificant as to not require an adjustment within the examination report. The determination of which errors to include in the examination report is up to the professional judgment of the examiner-in-charge. Often, the examiner may wish to exclude clearly immaterial misstatements in the exam report. Where an adjustment is not made, the examiner must ensure that these individually immaterial misstatements are not material in the aggregate or do not involve violations of law. The examiner must be able to summarize the exam results of each individual account balance and perform an overall error evaluation on unadjusted errors. Accordingly, to gauge the effect of each of the various errors, the examiner should complete the Exhibit BB – Summary of Unadjusted Errors worksheet, or a substantially similar document, to be placed within the examiner's workpapers that summarizes the aggregate effect of all uncorrected errors. Only errors that are above the passed adjusting journal entry scope should be included in the summary (see discussion in the Materiality Section of Section 1, Part III). Errors that the examiner has adjusted in the exam report should also not be included in this summary, although the examiner should maintain a separate summary that shows those adjustments that will be included in the examination report. The Summary of Unadjusted Errors separately identifies each error as to whether it is a known error or a likely error and summarizes its effect on the components of the financial statements. This allows the examiner to review the effects of the errors on the various financial statement components and to assess whether the aggregate effect of these errors is close to, or exceeds planned tolerable error, which may indicate whether certain unadjusted errors should be included in the examination report.

Examiners should always include both known and likely errors. Known errors are those errors that are quantifiable as a result of the testing procedures performed. For example, in performing substantive tests on premiums receivable, an examiner may determine from the evidence that a receivable listed as $10,500 on the company's books should have been recorded at $5,500. As such, premium receivables and, thus, premium income, would be overstated by $5,000. This would be considered a known error as the evidence clearly indicates.

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Likely errors may also be identified by the examiner, although the amounts cannot be exactly identified. These errors are identified through the extrapolation of misstatements found in a statistical sample or are based on the professional judgment and opinion of the examiner. An example of a likely error would be a disagreement over an accounting estimate, such as incurred but not reported (IBNR) reserves for a property/casualty company.

Having summarized the uncorrected misstatements, the examiner should consider the effects of the errors against planned tolerable error. If the aggregate known and likely unadjusted errors exceed, or are close to planned tolerable error, the risk that surplus may be materially misstated is high. If this situation occurs, the examiner should typically (1) make adjustments in the exam report for some or all of the known misstatements; and/or (2) have the company assist the examiner in evaluating the likely errors noted to determine if the actual evidence supports the examiner's assessed likely error. By utilizing one or both of these procedures, the examiner should reduce the aggregate Summary of Unadjusted Errors to an amount deemed acceptable by the examiner.

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V. REINSURANCE REVIEW

This section of the Handbook addresses the following subjects:

A. Evaluation of Risk Transfer
B. Credit for Reinsurance Guidelines
C. Reinsurance Balances Recoverable
D. Termination of Reinsurance Agreements

A. Evaluation of Risk Transfer

The examiner should review the procedures followed by the company in accordance with the selection of reinsurers and the ongoing monitoring of their financial condition. It is important to review all reinsurance documentation (placement slips, cover notes, reinsurance agreements and any addenda thereto) for significant reinsurance contracts for completeness, accuracy and timeliness, and to verify that acceptable forms of collateral (usually funds withheld, letters of credit or trust accounts) have been secured by the company in a timely manner for all amounts recoverable from unauthorized reinsurers.

Risk transfer is by nature an elusive concept. There is a variety of risk transfer agreements ranging from a purely financial arrangement in which no underwriting or timing risk is transferred to the reinsurer to a quota share arrangement in which no limitations on risk transfer other than those inherent in the original policies and the reinsurance agreement, are applicable to the obligations of the reinsurer.

Property/Casualty Reinsurance

For statutory accounting purposes, "risk" is defined in *SSAP No. 62R—Property and Casualty Reinsurance – Revised* (SSAP No. 62R), of the NAIC *Accounting Practices and Procedures Manual* as consisting of two distinct elements: underwriting risk and timing risk.

> Underwriting risk is the possibility that losses and expenses recoverable by the cedent from the reinsurer will exceed the consideration received by the reinsurer, thus resulting in an underwriting loss to the reinsurer.
>
> Timing risk exists when anticipated loss payment patterns are not considered during the development of recoverable losses under the reinsurance agreement and result in a reduction in investment income to the reinsurer as an effect of the accelerated loss payments.

Both of these elements of risk must be present in order to warrant reinsurance accounting treatment. The other elements of risk, including credit risk or yield risk, are inherent in most reinsurance agreements, and result in a reduction in investment income to the reinsurer as an effect of the accelerated loss payments.

There is no defined quantitative level of risk transfer that must be met before the transaction can be accounted for as reinsurance. The language in SSAP No. 62R requires only that the reinsurer assume significant insurance risk (i.e., underwriting and timing risk) and that a reasonable possibility exists that the reinsurer, in so doing, may sustain a significant loss from the transaction. The determination of what amount of risk is "significant" is to be made on a case-by-case basis by the regulator. The term "reasonably possible" is defined in Question #12 in SSAP No. 62R, Appendix A as any probability that is "more than remote." A common method for GAAP purposes is that there must exist at least a 10% probability that the reinsurer could sustain a loss of at least 10% of the premium paid on the transaction. Transactions that cannot satisfy statutory risk transfer requirements must be accounted for as deposits rather than reinsurance.

In determining how much credit should be allowed, it is necessary to examine closely the provisions of the reinsurance agreement. Limitations on the maximum amount recoverable from the reinsurer during any defined period (e.g., contract year) should serve to limit the amount by which gross losses may be reduced on the cedent's financial statements. Such limitations may take the form of loss ratio caps, per occurrence loss limits, loss "corridors" (a band of loss which must be assumed net by the company before the reinsurer becomes responsible for any further losses under the agreement) etc.

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The amount of credit allowed should be directly related to the amount of loss recoverable (i.e., for a "finite" amount of risk transferred to the reinsurer, no more than an equivalent "finite" amount of statement credit should be allowed).

Provisions in the reinsurance agreement that have the effect of deferring the reinsurer's obligation to reimburse covered losses will generally cause the transaction to fail the timing risk requirement, preventing the application of a credit for reinsurance. Examples of these provisions include "floating" retentions, "last dollar paid" arrangements, multiple-year retentions, payment schedules, or payment of reported losses less frequently than quarterly.

Examiners should determine whether any separate agreements or understandings exist between the reinsurance agreement parties that would serve to reduce, offset or eliminate the reinsurer's obligations. To the extent a unilateral right to commute the contract exists for either party, or both parties, risk transfer would be questionable. In any such instance, a credit for reinsurance should not be allowed under the reinsurance agreement. For property/casualty companies, the examiner should review the company's responses to the appropriate disclosures in the Annual Statement General Interrogatories to determine whether these types of situations exist.

An analysis of contract provisions is necessary to determine whether, and to what extent, reinsurance accounting treatment should be allowed. Even if the provisions in the reinsurance agreement satisfy risk transfer requirements, it is often necessary to perform an analysis of discounted cash flows, using reasonable assumptions as to the ultimate amount of recoverable incurred losses, loss payment patterns and interest rates, to determine whether there is a reasonable likelihood of a significant underwriting loss to the reinsurer. If this cannot be demonstrated, the transaction should be accounted for as a deposit.

In the simplified illustration that follows, if the probability of a loss ratio of 100% or higher on the business reinsured does not illustrate a greater than "remote" possibility, one would have to conclude that the transaction does not transfer sufficient risk to the reinsurer to warrant reinsurance accounting treatment.

Simplified Illustration of Cash Flow Analysis

Assumptions:

Ultimate loss ratio will be no lower than 75% and no greater than 125%

$5,000,000 premium less 20% ceding commission will be paid at inception of the reinsurance agreement

Interest rate = 5%, compounding annually

Paid losses will be recovered from the reinsurer at the end of each year as follows:

Year 1	20%
Year 2	35%
Year 3	20%
Year 4	15%
Year 5	10%
	100%

In determining whether reinsurance accounting is allowable, it should be noted that in certain instances the business covered by the reinsurance agreement might be inherently profitable. As long as the provisions of the reinsurance agreement place no limitations on the obligations of the reinsurer (i.e., the reinsurer's underwriting result can be expected to mirror that of the ceding company), commission impact aside, it would be appropriate to allow reinsurance accounting.

In reviewing the company's reinsurance arrangements, it is also important to determine whether any reinsurance agreement that was incepted or renewed on or after January 1, 1994, applies to losses occurring prior to the inception date of the agreement. Any such agreement must be accounted for as retroactive reinsurance, per the instructions set forth in SSAP No. 62R, unless the agreement meets any of the exceptions provided therein. Part Three of Exhibit N can be utilized by an examiner when reviewing a reinsurance contract.

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Life and Health Reinsurance

For life and health reinsurance, the evaluation of risk transfer is quite different from that for property/casualty reinsurance. *SSAP No. 61R—Life, Deposit-Type and Accident and Health Reinsurance – Revised* (SSAP No. 61R) requires a "transfer of significant risks inherent to the business reinsured." The regulation does not address the probability of loss to the reinsurer at all in defining "transfer of risk." "Significant risks" are defined in Appendix 791 of the *Accounting Practices & Procedures Manual* which includes a table of risks and contract types. The examiner should consult SSAP No. 61R for details concerning the evaluation of risk transfer for life and health reinsurance agreements. SSAP No. 61R specifically prohibits the use of side agreements, which differs from the property/casualty treatment of side agreements.

B. Credit for Reinsurance Guidelines

Note: In late 2011, the NAIC adopted revisions to the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786). These revisions serve to reduce reinsurance collateral requirements for reinsurers that have been "certified" by the domestic state of the ceding insurer. A number of states have adopted these revisions within their respective credit for reinsurance statute and/or regulation, and several additional states are considering similar proposals. If your state has adopted these revisions, you should refer to the model or your state's updated statute for the most current guidance regarding credit for reinsurance as it pertains to "certified reinsurers."

Subject to the laws of the various states, credit for reinsurance may be allowed to the ceding company when the reinsurance contract includes a proper insolvency clause and the specific criteria for the appropriate category have been adequately met:

1. Reinsurer is Licensed in the Ceding Company's Domiciliary State

   Reinsurers who meet this classification must have obtained their licensure status at the time the statutory financial statement credit for reinsurance is claimed or when financial statements indicating the credit have been filed by the ceding company. The reinsurer then must continue to maintain compliance with the licensure status at all times after the credit has been taken. The licensure requirement is considered to be perpetual and not periodic; therefore, appropriate information is required to be included in the company's financial statements when reinsurers do not comply with the requirements.

2. Assuming Insurer Has Obtained Reinsurer Accreditation

   An assuming insurer must have obtained reinsurance accreditation in the domiciliary state of the ceding company at the time the financial statement credit is claimed in order for the domestic insurer to receive a credit for reinsurance. In order to obtain the status of an accredited reinsurer, the assuming company must file a Form AR-1 (Certificate of Assuming Insurer), which grants specific authority to the ceding company's domiciliary insurance commissioner (Part Two of Exhibit N – Reinsurance Review), as well as documentation of licensure to transact insurance or reinsurance and annual statements with the domiciliary insurance commissioner. In addition, the assuming insurer must demonstrate to the satisfaction of the commissioner that it has adequate financial capacity to meet its reinsurance obligations and is otherwise qualified to assume reinsurance from domestic insurers. An assuming insurer is deemed to meet this requirement as of the time of its application if it maintains a surplus as regards policyholders in an amount not less than $20 million and its accreditation has not been denied by the commissioner within ninety (90) days after submission of its application. The insurance commissioner is entitled to suspend or revoke reinsurer accreditation if the above conditions are not preserved.

3. Reinsurer is Domiciled in Another State

   The reinsurer must be domiciled (and licensed) in a substantially similar state that has adopted the NAIC *Credit for Reinsurance Model Law* (#785) or substantially similar law and, therefore, is subject to that state's credit for reinsurance standards at the time the financial statement credit for reinsurance is claimed. The reinsurer must also maintain a surplus of at least $20 million and file a Form AR-1 with the insurance commissioner.

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4. Reinsurer Maintains Trust Funds

A credit for reinsurance ceded by domestic insurers is available to assuming insurers that maintain trust funds for a requisite amount in a qualified U.S. financial institution (actual amount is determined by the classification of the assuming insurer). The assuming insurer is required to annually report to the insurance commissioner for determination of the sufficiency of the trust fund. The classifications of assuming insurers are as follows:

a. Single Assuming Insurer – Trust funds must equal or exceed the assuming insurer's liabilities attributable to ceded reinsurance by U.S. domiciled insurers. In addition, the assuming insurer shall maintain a trusteed surplus of at least $20 million. If the assuming insurer has permanently discontinued underwriting new business secured by the trust for at least three full years, the commissioner may authorize a reduced required trusteed surplus to an amount no lower than thirty percent (30%) of the assuming insurer's liabilities attributable to reinsurance ceded by the U.S. ceding insurers covered by the trust.

b. Incorporated and Unincorporated Group Underwriters – For reinsurance ceded under reinsurance agreements dated after January 1, 1992, trust funds must equal or exceed the group's liabilities for business ceded by U.S. domiciled ceding insurers. For reinsurance agreements dated before December 31, 1992, trust funds must at least equal the insurance and reinsurance liabilities attributable to business written in the United States. In addition to these trusts, the underwriters must maintain $100 million in surplus for the benefit of U.S.-domiciled ceding insurers. The incorporated members of the group are prohibited from engaging in auxiliary business, other than underwriting as a member of the group, and must be subject to the same regulation and control of the group as the unincorporated members. The group is also required to annually file either a certification of solvency for each underwriter member or independently prepared financial statements for each underwriter to the insurance commissioner.

A credit for reinsurance will not be granted for reinsurers who maintain trust funds, unless the insurance commissioner of the state where the trust is domiciled has approved the form of the trust. An insurance commissioner from another state may approve the trust if the commissioner has accepted responsibility for the regulatory oversight of the trust. The form of the trust is required to be filed with the insurance commissioner in every state the ceding insurer beneficiaries of the trust are domiciled.

5. Certified Reinsurers

An assuming reinsurer must have obtained certification by the commissioner of the domiciliary state of the ceding company at the time the financial statement credit is claimed in order for the domestic insurer to receive a credit for reinsurance. In order to obtain the status of certified reinsurer, the assuming reinsurer must be domiciled and licensed to transact insurance or reinsurance in a qualified jurisdiction, as determined by the commissioner. The assuming reinsurer must also maintain a surplus level of no less than $250 million and maintain financial strength ratings from two or more acceptable rating agencies.

The allowable credit for reinsurance ceded by a domestic insurer to an assuming reinsurer that has been certified as a reinsurer in the domestic insurer's state is based upon the security held by, or on behalf of, the ceding insurer (e.g., amount of funds held, letter of credit, etc.). The amount of security required to be held (e.g., level of collateral required) corresponds to the rating assigned to the certified reinsurer by the commissioner, which is based on various factors including, but not limited to, the certified reinsurer's business practices, regulatory actions against the certified reinsurer, financial strength and the report of the independent auditor.

6. Credit for Reinsurance is Required by Law

For those jurisdictions in which reinsurance is required by law, the domestic ceding insurers may take a credit for reinsurance, even though the assuming insurer does not meet the requirements set forth in the above sections. Examples of the assuming insurers for which credit may be allowed include state-owned or controlled insurance or reinsurance companies, guaranty organizations and residual required market mechanisms.

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7. Assuming Insurer is Unauthorized and Not Included Within the Previous Categories

A credit for reinsurance may also be granted to the ceding company even when the assuming insurer does not meet any of the above credit-permitted categories. In these instances, if the ceding insurer holds funds or is exclusively entitled to funds held in a U.S. institution provided as security for reinsurance obligations, the ceding insurer is permitted to take a reduction of liability or record an asset. The reduction is not permitted to exceed the liabilities carried by the ceding insurer. The funds held may take the form of cash, qualifying admitted asset securities as indicated by the NAIC Securities Valuation Office, letters of credit, and any other security that has been approved by the insurance commissioner. In order for the letters of credit to be accepted, they must be clean, irrevocable, unconditional, and issued or confirmed by a qualified U.S. financial institution. In addition, they must have an "evergreen" clause that indicates the letter cannot expire without 30-day advance notice and provide notice on what laws the letter of credit is governed by (e.g., state law, Uniform Customs and Practice for Documentary Credits of the International Chamber of Commerce, or any other publication). An example letter of credit form is included in the Handbook as Part One of Exhibit N.

In addition to the categories addressed above, the ceding insurer may take credit for unencumbered funds withheld by the U.S. ceding insurer that are under the exclusive control and withdrawal of the ceding insurer. However, no credit, asset or reduction from liability will be permitted for reinsurance agreements that do not contain a proper insolvency clause. Additionally, unauthorized assuming insurers must submit and comply with requirements of a U.S. jurisdiction.

Credit will not be allowed to a ceding company for reinsurance cessions under contracts incepting on or after January 1, 1980, where payments are made via an intermediary, unless the reinsurance agreement includes a provision whereby the reinsurer assumes all credit risks of the intermediary related to payments to the intermediary.

Certain special requirements must be satisfied before credit for reinsurance may be taken with respect to life and health reinsurance structured on a proportional basis. These requirements are set forth in the NAIC Life and Health Reinsurance Agreements Model Regulation, which has been adopted in one form or another by nearly all of the states.

Reinsurers applying for accredited or authorized status (or, in the case of reinsurers domiciled outside the United States, "trusteed" status) in states which they are not licensed must provide to the Commissioner in such states a properly executed Form AR-1 (Part Two of Exhibit N) as evidence of their compliance with the requirement to designate the Commissioner as agent for receipt of service of process and to recognize the Commissioner's authority to examine their books and records.

(The examiner should refer to Appendix A-785 in the NAIC *Accounting Practices and Procedures Manual* for additional guidance on Credits for Reinsurance.)

Credit for Reinsurance – Lloyd's Syndicates

The credit for reinsurance laws in nearly all of the states allow credit to be taken for reinsurance cessions to syndicates at Lloyd's, based on the premise that Lloyd's American Trust Fund, which is maintained in New York, contains assets sufficient to collateralize all of the insurance and reinsurance liabilities arising out of business written by such syndicates in the United States, including non-U.S. business denominated in U.S. dollars, plus an amount, to be held on a joint basis, of no less than $100 million over and above the syndicates' total U.S. liabilities.

Beginning with cessions under reinsurance agreements with an inception, anniversary or renewal date on or after January 1, 1993, collateral for U.S. reinsurance liabilities assumed by syndicates at Lloyd's will no longer be afforded on a collective basis via Lloyd's American Trust Fund; each syndicate writing U.S. situs reinsurance business (i.e., reinsurance ceded by an insurer domiciled in the United States) must subscribe a deed of trust under the terms of which the syndicate undertakes to maintain assets in a separate trust account in an amount equal to its total gross liabilities arising out of its assumed U.S. situs reinsurance business. Statement credit for reinsurance ceded to syndicates not participating in the new collateralization arrangement would be allowable only upon demonstration that adequate specific

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collateral has been provided to the cedent. Additionally, Lloyd's has undertaken to maintain a joint trusteed surplus in the amount of $100 million.

The trustee is obligated to file no later than February 28, of the year following the year for which the ceding company has taken credit on its financial statement for reinsurance ceded to a "trusteed" alien reinsurer or to syndicates at Lloyd's maintaining U.S. situs reinsurance trust accounts, a statement indicating the balance in such accounts as of the date of the ceding company's financial statement and describing the assets held in the account. The trustee's statement is to be filed with each state in which a domestic insurer has taken such reinsurance credit.

Note that Lloyd's syndicates are also eligible for status as a "certified reinsurer" in the states that have adopted collateral reduction provisions under the NAIC's revised *Credit for Reinsurance Model Law* (#785) and the *Credit for Reinsurance Model Regulation* (#786). The trust fund described above does not include collateral for liabilities arising out of business written by Lloyd's syndicates under "certified reinsurer" status, as such liabilities are collateralized separately. At present, collateral applicable to liabilities assumed under "certified reinsurer" status is provided to each individual ceding insurer.

Information regarding total U.S. assumed reinsurance liabilities of trusteed alien reinsurers and syndicates at Lloyd's maintaining U.S. situs reinsurance trust accounts can be obtained directly from the NAIC database; if assistance is required in that regard, the examiner should contact the NAIC Financial Regulatory Services Division.

C. Reinsurance Balances Recoverable

Reinsurance balances recoverable from the company's reinsurers should be evaluated on the perceived financial condition of the reinsurer. The examiner should evaluate the likelihood that the company will receive all of the amounts recoverable from that reinsurer in a timely manner. Receipt of receivables from reinsurers should be consistent with the actual payment of claims under the policy's reinsured, in accordance with the reinsurance agreement settlement provisions, and in line with established aggregate or catastrophe reinsurance protections.

The appropriate maintenance of reinsurance records is a critical and fundamental element to ensure collection of reinsurance recoverables for any insurer. As part of the process to evaluate the collectibility of reinsurance balances recoverable, the examiner should determine whether the insurer has adequate processes in place to maintain appropriate record keeping for reinsurance transactions. Some questions to consider in this regard include the following:

- Are key records associated with reinsurance appropriately maintained and easily accessible?
- Are treaties signed?
- Does billing documentation conform to standards defined in the reinsurance contract?
- Can the company supply records that support an inception-to-date position on a treaty for both premiums paid to the reinsurer as well as indemnity and paid LAE recovered from reinsurance?
- Are reinsurance records electronic or hard copy and is access to such records appropriately restricted?

An evaluation of the current financial condition of all reinsurers from which material balances will eventually become recoverable should be completed, with the examiner focusing first on the reinsurer with the most assumed risk. Review of the most recent annual statement will provide an overview of all recoverable balances for this purpose. In accordance with the review, the examiner should determine the degree to which the company's statutory surplus may be exposed to erosion in the event of unrecoverable reinsurance.

The introduction of statutory penalties for delinquent property and casualty reinsurance recoverables appears to have had the intended effect of accelerating cash recoveries. If, however, the examiner finds evidence of difficulty in making timely recoveries, the company's overall exposure to potentially unrecoverable balances should be thoroughly investigated. Balances recoverable from reinsurers known to be in liquidation should be viewed with considerable skepticism. The examiner should verify that reinsurance balances deemed uncollectible are properly written off and that reinsurance recoverables from unauthorized reinsurers are reported as an asset and a liability (as necessary) to comply with statutory accounting rules. Additionally, any penalties assessed from authorized overdue reinsurance balances should be recorded as a liability.

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D. Termination of Reinsurance Agreements

1. Reinsurance Treaties

Reinsurance treaties may be written either on a "continuous until canceled" basis, or for a defined period of time, usually 12 months. Contracts written on a continuous basis will ordinarily contain a termination clause that will indicate which party may initiate termination (usually either party, but in some instances the reinsurer may effect termination only under certain defined circumstances), the date by which intent to terminate must be communicated to the other party (usually at least 90 days prior to the anniversary date of the agreement), and the date on which termination will be effective, assuming that the termination notice has not been rescinded.

It is not unusual for reinsurers to issue a "provisional notification of intent to terminate" prior to the notification date stipulated in the agreement. The reinsurers complete this in order to preserve the right to terminate while awaiting receipt of pertinent updated underwriting information that the reinsurer desires to review in order to determine whether it will continue the existing arrangement, or its participation therein, or whether modifications in current terms and conditions may be appropriate. Upon receipt and review of this data, if the reinsurer decides to continue, the "provisional" notice should be rescinded.

When a continuous agreement is terminated, it is necessary to indicate clearly what is to be done regarding business in-force as of the termination date. For reinsurance agreements, there are two methods to terminate in-force business. To address these situations, the contract may indicate use of the "cut-off" basis or use of the "run-off" basis. Under the cut-off basis, the reinsurer remains liable for losses occurring prior to the termination date, but not for losses occurring at any time thereafter. Under the run-off basis, the reinsurer remains liable for losses occurring on policies in-force as of the termination date of the reinsurance agreement, usually until the earliest of the expiration, termination or next anniversary date of the original policies.

If the reinsurance agreement contemplates remittance of reinsurance premium on the basis of written rather than earned premium, termination on a cut-off basis will require the reinsurer to return the unearned premium, calculated as of the termination date, to the ceding company. Reinsurance agreements written for a specific term usually cover only losses occurring during that period and the reinsurance premium is usually based on earned premium, so the issues of run-off protection or return of the unearned premium portfolio do not typically occur.

Life & Health Reinsurance

Life reinsurance agreements generally may be terminated with respect to new business. Such termination is effected by either the ceding company or the reinsurer giving advance notice to the other. The reinsurer may also terminate all reinsurance for non-payment of reinsurance premiums or the parties may mutually agree to terminate the agreement for the in-force reinsurance. In the latter case, since such termination is under the control of the ceding company, a commonly encountered provision obligates the ceding company to indemnify the reinsurer for adverse experience ceded and in-force as of the termination date. Some forms of health reinsurance differ from life reinsurance in that they may be annually renewed. With these forms of reinsurance, if reinsurance is not renewed, all reinsurance terminates at the end of the agreement period.

Health Reinsurance

Health entities generally require prior notification (i.e., 60 days) before their contracts can be terminated, except for non-payment of premium. Most health contracts have termination language that allows for automatic termination in the event of insolvency or cessation of operations. In the event of either of these events, the continuation of benefits clause should be triggered which requires the reinsurer to be liable for all claims incurred from the date of insolvency through the next 31 days. This prospective of first dollar coverage is not normally found in other types of reinsurance. It may require that the reinsurer be licensed to write direct Accident and Health Insurance in the state(s) that the health entity does business. In addition, continuation of benefits clauses typically require that the reinsurer pay claims from the date of insolvency through the earlier of the date of discharge for a member who is confined to an impatient facility, or the date the member becomes eligible for health coverage under another plan. Continuation of benefits clauses may also contain other limitations as well. The coverage may also provide that the reinsurance company continue benefits for any member for medical services incurred for a service date subsequent to the date of insolvency provided that premium for the members

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is current. Historically, continuation of benefits clauses have not contained maximum limits. However, more recently, reinsurers have attempted to insert dollar limits to avoid large exposure under the provision resulting from the insolvency of a large health entity. It is imperative that the language included in the continuation of benefits clause match the language in the insolvency clause so there is no gap in coverage for the members covered by the plan.

Some states require 60-days prior written notification to the plan and the commissioner of insurance for termination for any cause, including the non-payment of premiums.

2. Facultative Certificates

Certificates of facultative reinsurance usually have termination dates that are coterminous. In these situations, the reinsurance agreement terminates automatically with the termination date of the original policy.

3. Commutation

Reinsurance agreements often create obligations, particularly to the reinsurer, which would not be entirely fulfilled until long after the agreement has expired or been terminated. Many agreements contain a commutation clause, which provides a basis upon which the parties can agree on the net present value of estimated future loss payments. The commutation clause basis entails a careful actuarial analysis of reserves for reported and unreported losses as well as expected timing of loss payments by the cedent. Upon payment by the reinsurer of the agreed amount, the cedent will execute an agreement relieving the reinsurer from any further responsibility for such losses.

The commutation arrangement may apply to the entire reinsurance agreement or only to certain elements thereof, (such as to specific claims, or certain types of covered business, e.g., workers compensation, medical malpractice or long-term disability), or only to losses attributable to specific accident years. In the event of partial commutation, the balance of the reinsurance relationship and the respective responsibilities of the parties will remain unchanged. Since the net present value consideration received by the ceding company will invariably be less than the ultimate undiscounted value of losses originally ceded to the reinsurer, the company will sustain an immediate reduction in surplus. As a result, the reinsurer will realize an immediate increase in surplus as a result of the commutation. The examiner should ascertain whether all such transactions have been properly accounted for and properly disclosed in the financial statements in accordance with SSAP No. 62R, paragraphs 68-71 and SSAP No. 61R, paragraph 57.

4. Rescission

The rescission of a reinsurance agreement is effectively the retroactive termination of the contract at inception. Under this method the respective rights and obligations arising under the contract are entirely voided, and the parties are thereby restored to their respective positions prior to inception of the agreement. This may occur by mutual agreement of the parties or may be the remedy that is granted by an arbitration panel or court in cases where one party, more commonly the reinsurer, is able to demonstrate that it has been irreparably damaged as a result of reliance upon deliberate material misrepresentations made by the other party.

5. Novation (Assumption Reinsurance)

A novation, strictly speaking, does not serve to terminate a contract. It is a legal process whereby one of the original parties is replaced by another person or entity, with the result that all rights and obligations of that original party are assumed, as of the date of the novation, by the new person or entity. Ordinarily, other terms and conditions of the agreement will not be affected by the novation itself, although they may subsequently be amended by mutual consent, consistent with contract provisions and subject, where applicable, to regulatory approval.

In the insurance industry such transactions have generally been characterized as “assumption reinsurance.” This is really a misnomer, since in an ordinary indemnity reinsurance arrangement no novation occurs, as the insurer’s liabilities to its policyholders are not eliminated or reduced by virtue of the existence of reinsurance protection. However, the term is widely used in both industry and the regulatory community. Since long-term, non-

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cancelable policies are preponderantly found in the life and health sector, assumption transactions are utilized much more extensively there than in the property/casualty sector.

Having disposed of a block of in-force business by means of an assumption by another insurer, the original insurer may still be obligated to fulfill contractual responsibilities to policyholders who have explicitly rejected the transfer of their policies to the new insurer. Additionally, the insurer may have contingent obligations to policyholders whose consent has not been received prior to the established deadline after which the novation will be considered as a matter of law. In such cases, the examiner should determine whether the company has appropriately reflected reserves for residual or contingent exposure in its financial statements. In order to prevent these issues, many companies will 100% coinsure until approval of assumptions by all states are received.

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VI. LIFE INSURANCE RESERVE REVIEW

This section covers procedures and considerations that are important when conducting financial condition examinations of life insurance reserves. The discussion here is divided as follows:

A. Life Insurance Reserve Overview
B. Formula Based Valuation Methodology
C. Principle-Based Valuation Methodology
D. Actuarial Opinion and Asset Adequacy Analysis
E. Actuarial Oversight and Internal Controls

A. Life Insurance Reserve Overview

Life insurance reserves represent the liability established by the insurance company to pay future policy benefits such as death benefits upon the death of the insured, endowment benefits upon the maturity of a life insurance policy and cash surrender benefits upon the surrender of the life insurance policy. Historically, the company liability to pay future policy benefits has been determined by calculating a reserve based on a formula valuation methodology as described below. Life insurance products have evolved over time and today, such products may be quite complex offering multiple benefits and/or options to the policyowner or the insured or both the policyowner and the insured within a single contract such as death benefits, accelerated death benefits, secondary guarantees such as no-lapse guarantees, policy loans, retirement income benefits such as guaranteed lifetime income benefits and long-term care benefits. The value of some of these complex benefits depends upon the current and future market value of the underlying assets. Regulators have found it increasingly difficult to define or modify a formula based valuation methodology to value all the options and/or benefits in a single contract. This complexity of current insurance products along with the fact that the value of certain benefits depends upon the current and future market value of underlying assets has led to the development of a principle-based valuation methodology which incorporates the value of both assets and liability cash flows. The principle-based valuation methodology is described below.

In order to implement the principle-based valuation methodology, amendments to the Standard Valuation Law were adopted in 2009 and a Valuation Manual was developed. The Valuation Manual which is referred to in the amended Standard Valuation Law provides reserve requirements for life, health, and annuity products issued on and after the manual's operative date. Requirements include all of the details of the methodology for determining a principle-based reserve as well as any changes to the formula based valuation methodology that occurs on and after the operative date of the Valuation Manual. The operative date of the Valuation Manual is January 1, 2017. Unless a change in the Valuation Manual specifies a later effective date, changes to the Valuation Manual shall be effective January 1 following the date when the change to the Valuation Manual has been adopted by the NAIC by an affirmative vote of at least three-fourths (3/4) of the members of the NAIC voting but not less than a majority of the total membership and such members voting in the affirmative represent jurisdictions totaling greater than 75% of the direct premiums written as reported in the most recent life, accident and health annual statements, health annual statements, or fraternal annual statements. No state legislative adoption is needed to effect changes to the Valuation Manual.

The Valuation Manual defines the insurance contracts that are subject to a principle-based valuation (Section II). Unless otherwise specified in Section II of the Valuation Manual, the principle-based valuation methodology will apply to life insurance contracts issued on or after the operative date of the Valuation Manual, however a company may elect to defer the implementation of the principle-based valuation methodology to life insurance contracts issued during the first 3 years following the operative date of the Valuation Manual. Since elements of the Actuarial Method in AG 48 are based on VM-20, a company may "partially implement" the Valuation Manual during the deferral period even though for new business the company otherwise defers implementation.

Actuarial Guideline 48 (AG 48) was adopted December 16, 2014 with an effective date of January 1, 2015 and refers to the Actuarial Method which is also a principle based methodology that companies may use in evaluating level of primary assets held by captive insurers in support of reserves. If regulators determine that the insurer under examination has business subject to AG 48, they may also consider the involvement of a credentialed actuary and may apply the concepts discussed in evaluating PBR.

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A Valuation Analysis Working Group (VAWG) consisting of regulators with expertise in actuarial, financial analysis and examination experience reports to the Financial Condition (E) Committee and supports the states in the review of Principle-Based Reserves (PBR) to ensure consistent implementation and application of the methodology. VAWG will also suggest necessary changes to the Valuation Manual to enhance clarification and interpretation of application of the principle-based valuation methodology.

In addition, NAIC actuarial staff is available to provide expertise in modeling insurance cash flows to assist individual states and VAWG in conducting analyses and examinations to verify the PBR and exclusion test calculations performed by the company.

Due to the complexities of life insurance products, the involvement of a credentialed actuary is required on all examinations of life and health insurers with a substantial amount of interest-sensitive business or with a substantial amount of PBR calculations or subject to PBR exclusion tests See Section 1, Part III, E. Use of the Work of a Specialist for further reference.

B. Formula Based Valuation Methodology

Theoretically, the formula based reserves represent the present value of future guaranteed benefits reduced by the present value of expected future net premiums. The insurance policy is a unilateral contract whereby the insured can cancel the agreement to pay premiums at any time. However, the insurer is "locked in" regardless of future experience and cannot forfeit on its guarantees as long as the premiums are paid. Life reserves are required in order to ensure that commitments made to policyholders and their beneficiaries will be met, even though the obligations may not be due for many years. Since the primary purpose of life reserves is to pay claims when they become due, life reserves must be adequate and the funds must be safely invested.

The Valuation Manual prescribes the minimum standards to be used in determining the formula based reserves as applicable in addition to principle-based reserves as discussed elsewhere in this document. Currently for most formula based reserves, the manual refers to requirements in the NAIC *Accounting Practices and Procedures Manual* (AP&P Manual). Insurers may establish life reserves, which equal or exceed these minimum standards. These minimum life reserve standards specify a: 1) valuation mortality table; 2) maximum valuation rate of interest; and 3) valuation method. The valuation method used to define minimum life reserves for statutory accounting purposes is referred to as the Commissioners Reserve Valuation Method (CRVM). The mortality assumptions are higher than what the insurer can expect to realize from medically underwritten insurance policies. The interest rate assumptions are intended to be significantly lower than current money and capital market yields. Thus, the life reserves developed are generally conservative.

There are three general valuation methods under a formula based valuation methodology used to value life reserves. The net level premium method does not provide for a first-year acquisition cost allowance in determining life reserves. Therefore, this method results in the most conservative, or highest, life reserve valuation of the three methods. The full preliminary term method does provide a first-year expense allowance and then assumes that the remaining premium stream is used to cover policy benefits. The Commissioners Reserve Valuation Method (CRVM) is a form of the full preliminary method. This method allows for a lower life reserve valuation than the net level premium method in the earlier years of the policy term. The modified preliminary term method is a variation of the two methods described above and results in a reserve valuation between the net level premium and preliminary term methods.

As described below, the type of life insurance policy dictates the amount of the life reserve that must be established and the duration for maintaining the reserve. In addition, special situations arise which require unique reserving techniques. The following summarizes the major types of life insurance policies, and the related reserving implications under a formula based valuation methodology:

1. Ordinary Life Reserves

   Under a whole life plan of insurance, the insurer is obligated to maintain a reserve until the death of the insured. Term life insurance provides coverage only for the period that is specified in the policy. Under a term insurance plan, the insurer must maintain a reserve, which reduces to zero upon expiration of the term period. Similar to

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term insurance, endowment life insurance provides coverage for a period specified in the policies. Unlike term insurance, the proceeds of endowment insurance are payable if the insured lives to the end of the period. Policies, which permit flexible premium payments, are referred to as "universal life" policies and those with fixed premiums are referred to as "interest sensitive" policies. Universal life policies are accumulation type policies where the current account value is determined based upon the accumulation of premiums less mortality charges and expense charges, plus a current interest rate credit. The account value less surrender charges is the cash value. Because of the unique features of universal life and interest sensitive types of policies, unique reserving requirements are specified for them in Appendix A-585, *Universal Life Insurance*, of the AP&P Manual. The minimum standard for universal life reserves consider guarantees within the policy at the time of issue, present value of future guaranteed benefits, account value and cash value.

2. Group Life Reserves

   Most group life insurance is monthly renewable term insurance. For these policies, gross premiums are typically recalculated periodically, most often annually, using the age and sex census of the group along with experience adjustments. Therefore, the reserve is usually calculated as the unearned premium or a percentage thereof to estimate the claim exposure. However, some group life insurance policies provide permanent or longer term benefits analogous to individual coverages. In these cases, the reserving methods are similar to those employed for individual insurance, using appropriate mortality tables. Appendix A-820 does not specify a mortality table for group life insurance but leaves that to the discretion and approval of the domiciliary state.

3. Industrial Life Reserves

   Industrial life insurance is unique in that it involves higher unit premiums, smaller face amount policies and higher mortality expectations. The minimum standards for reserves are the same as the traditional life insurance except that a unique mortality table is used.

4. Credit Life Reserves

   Credit life insurance policies are designed to discharge a debt upon the debtor's death. They are usually funded as a single premium. Reserve requirements vary among the states. Key considerations include claims reserves and policy reserves based on a state-specified combination of mortality reserves, unearned premium reserves, and potential refunds. Credit Life and Disability Reserves are addressed in Valuation Manual (VM)-26.

5. Life Reserves Relating to Riders

   Life insurance policies frequently include riders for additional benefits such as accidental death and disability and waiver of premium upon disability. The minimum valuation standards for reserves are the same as for the base life insurance except that specialized mortality and disability tables are used and the net level premium valuation method is required.

6. Miscellaneous Life Reserves

   There are various other special situations involving life reserves. First, a deficiency reserve may be required in situations where the actual policy gross premium is less than the valuation net level premium. This situation occurs when pricing assumptions are used that are different from the minimum reserve valuation standards. This does not necessarily indicate that the policy is being sold at a loss by the insurer, but rather is a reflection of the highly conservative nature of the minimum reserve valuation standards. Second, there may be unusual situations where the cash surrender value of a life insurance policy is greater than the minimum reserve standard. In these situations, life reserves must be increased by the amount of this excess.

7. Minimum Aggregate Reserves

   In the aggregate, policy reserves for all life insurance policies valued under a formula based valuation methodology that are reported in the statutory financial statements must equal or exceed reserves calculated by using the assumption and methods that produce the minimum formula standard valuation.

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C. Principle-Based Valuation Methodology

In general, under a principle-based valuation methodology, all of the liability cash flows emanating from the contract benefits provided in the product are determined for each period and compared with all of the asset cash flows for each period determined from the assets the insurance company has purchased or plans to purchase or sell to fund the liability cash flows. The resulting differences between the asset and liability cash flows for each period are valued under a range of likely or plausible economic scenarios.

The principle-based valuation methodology developed for life insurance contracts defines 3 components of a principle-based reserve: 1) a net premium reserve (NPR); 2) a deterministic reserve (DR); and 3) a stochastic reserve (SR). The level of risk embedded in a life insurance contract will determine whether the principle-based reserve will consist of all 3 reserve components (NPR, DR, SR), or only 2 reserve components (NPR, DR); or only 1 reserve component (NPR). The principle-based valuation methodology defines a stochastic exclusion test and a deterministic exclusion test each of which are designed to measure the level of risk embedded in a life insurance contract. Life insurance contracts that pass an exclusion test are then exempt from the calculation of the associated principle-based reserve component. For example, all life insurance contracts that pass the stochastic exclusion test but fail the deterministic exclusion test, must calculate the NPR and DR components. Life insurance contracts that pass both the stochastic and deterministic exclusion tests need only calculate the NPR component. For groups of policies other than variable life or universal life with a secondary guarantee, a company may provide a certification by a qualified actuary that the group of policies is not subject to material interest rate risk or asset return volatility risk in lieu of performing the stochastic exclusion ratio test or stochastic exclusion demonstration test. In addition, a company is not required to compute stochastic reserves and deterministic reserves on any of its ordinary life policies if it meets the conditions of Section 2 of VM-20 referred to as the "companywide exemption". If the domestic commissioner does not reject a company's application for the companywide exemption pursuant to Section 6 of VM-20, then the company will compute reserves for its ordinary life policies per the requirements provided in VM-A and VM-C of the Valuation Manual.

The stochastic reserve under a principle-based valuation methodology is determined as a function of the discounted value of the differences between the asset and liability cash flows for each period over the range of economic scenarios. Economic scenarios may consist of interest rates or market returns or both depending on the nature of the asset and liability cash flows. A single economic scenario represents multiple consecutive periods (such as 30 or 40 years) of movements in the underlying interest rate or market rate returns. The length of the scenario period is determined by the length of the liabilities being valued. The economic scenarios are stochastically (randomly) generated using a prescribed Economic Scenario Generator (ESG). The prescribed ESG can be found on the Society of Actuaries website. The objective is to determine if there is a reasonable likelihood that assets are insufficient to cover the obligations of the company, and by what amount they may be insufficient. Under economic scenarios where assets are insufficient, the principle-based methodology determines all the amounts of the insufficiencies and discounts them back to the valuation date. The largest discounted value is known as the Greatest Present Value of Accumulated Deficiencies, or "GPVAD", for that scenario. The stochastic reserves may be set at a CTE(70) level (conditional tail expectation at the 70% level). The function CTE(70) means the average of the 30% (100%-70%) worst (largest) GPVADs. So for example if a company randomly generates 1,000 economic scenarios, it would then determine the largest accumulated amount of deficiency for each of the 1,000 scenarios. The CTE(70) stochastic reserve level would be determined by taking the average of the 300 [1,000 x (100% - 70%)] worst GPVADs out of the 1,000 scenarios.

Note that some states incorporated a "companywide exemption" in the Standard Valuation Law that may override Section 2 of VM-20. In such cases the state's Standard Valuation Law will determine whether a company is not subject to computing the stochastic and deterministic reserves. Note also, the commissioner may exempt specific product forms or product lines of a domestic company that is licensed and doing business only in a single state as defined in Section 15 of the amended NAIC Model Standard Valuation Law.

As part of the calculation process, the principle-based valuation methodology allows companies to aggregate or group policies with similar risk characteristics. For example, all term policies that provide only a death benefit and do not provide any cash surrender values may be grouped together by underwriting class. The exclusion tests are then applied on a group or aggregated basis and not a contract by contract basis. Also, the DR and the SR are calculated on the aggregated or group basis. However, the SR must be performed using aggregation subgroups that do not intermingle

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multiple product groups (Term, ULSG, Other). The NPR component is a fully prescribed formula based reserve and must be applied on a contract by contract basis.

The annual statement blank contains a VM-20 Supplement. This supplement breaks out the principle-based reserve into its various components of NPR, DR and SR. Regulators may request the assistance of NAIC modeling staff and or VAWG in verifying exclusion testing as well as various components of the principle-based reserve on a smaller sample set of company contracts.

D. Actuarial Opinion and Asset Adequacy Analysis

Due to the complexity in determining life reserves, insurers must rely on actuaries to assist with valuation of these reserves. Insurers are required to annually obtain an opinion regarding the reasonableness of the reserves by a qualified actuary who is appointed by the company. The actuarial opinion requirements are provided in VM-30 of the Valuation Manual. These requirements also include requirements for asset adequacy analysis. As a result of the asset adequacy analysis conducted by the appointed actuary, the actuary may conclude that the insurer's assets are not adequate to cover future liabilities as valued by the calculated reserves. When this occurs, reserves must be increased by the estimated deficiency resulting from asset adequacy testing.

E. Actuarial Oversight and Internal Controls

Appendix G of the Valuation Manual provides guidance that while not expanding the existing legal duties of a company's board of directors, senior management, and appointed actuary and/or qualified actuaries, provides guidance that focuses on their roles in the context of principle-based reserves. Some of the duties and expectations for the board of directors and senior management are provided below. If an actuarial specialist is involved in an examination, Appendix G includes additional requirements that should be considered during the review of the company's actuarial oversight and associated internal controls.

1. The Board of Directors should:

    a. Receive and reviews reports, including the certification of the effectiveness of internal controls with respect to the principle-based calculation, as provided in Section 12.B.(2) of the Standard Valuation Law.
    b. Understand the process undertaken by senior management to correct any material weaknesses in the internal controls with respect to a principle-based reserve valuation, if any is identified.
    c. Understand the infrastructure (consisting of policies, procedures, controls and resources) in place to implement and oversee principle-based reserve processes.
    d. Ensure the proper documentation of review and action undertaken by the board relating to the principle-based reserving function in the minutes of all of the board meetings where such function is discussed.

2. Senior Management should:

    a. Ensure that an adequate infrastructure (consisting of the risk tolerances, policies, procedures, controls, risk management strategies and resources) has been established to implement the principle-based reserving function.
    b. Review for reasonableness the principle-based reserving elements (consisting of the assumptions, methods and models used to determine principle-based reserves of the insurer company or group of insurance companies) that have been put in place.
    c. Review the principle-based reserving results for consistency with established risk tolerances of the insurance company or group of insurance companies in relation to the risks of the products of the insurance company or group of insurance companies offers, the various strategies used to mitigate such risks, and its emerging experience, in order to understand the general level of conservatism incorporated into principle-based reserves.
    d. Review and address any significant and/or unusual findings in light of the results of the principle-based reserve valuation processes and applicable sensitivity tests of the insurance company or group of insurance-companies.

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As examiners perform both the Corporate Governance assessment and the examination interviews, the topics above should be considered to ensure that the companies with transactions goverened by PBR are adequately implementing the relevant portions of the Valuation Manual.

Additional procedures regarding the examiners' assessment of the insurer's PBR related risks, controls, and possible test procedures can be located in Section 3 Reserves/Claims Handling (Life) repository.

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VII. SPECIAL CONSIDERATIONS FOR RISK RETENTION GROUPS

This section covers procedures and considerations that are important when conducting financial condition examinations of risk retention groups. The discussion here is divided as follows:

A. Background
B. Examination Coordination
C. Risk-Focused Examination Considerations
    1. Corporate Governance Assessment
    2. Conducting Interviews
    3. Consideration of Information Technology (IT) Risks
    4. Identification and Testing of Controls

A. Background

A risk retention group (RRG) is a risk-bearing entity that must be chartered and licensed as an insurance company in one state. Once the group has obtained a license, it may operate in all states without the necessity of a license and is regulated almost exclusively by the domiciliary commissioner. However, non-domiciliary commissioners are granted authority to monitor the financial solvency of RRGs and to examine RRGs under certain circumstances outlined in the NAIC *Risk Retention and Purchasing Group Handbook*.

The Federal Liability Risk Retention Act of 1986 (LRRA) requires that an RRG be owned by its insureds and that those insured be engaged in similar businesses related to the liability exposures resulting from common trade practices, products, services, premises or operations. The only type of coverage an RRG is permitted to write is commercial liability insurance for its members and reinsurance with respect to the liability of any other risk retention group (or any members of another risk retention group) that is engaged in business or activities so that the group or member meets the requirement for membership in the risk retention group which provides the reinsurance.

While RRGs may be subject to unique or specialized laws or examination procedures, their multi-state activity, if any, subjects them to the baseline regulatory practices and procedures outlined in the NAIC *Administrative Policies Manual of the Financial Regulation Standards and Accreditation Program.* Most RRG insurers file their financial statements on a modified United States Generally Accepted Accounting Principles (GAAP) basis. The NAIC *Annual Statement Blank and Instructions* and many of the corresponding Financial Analysis Solvency Tools have not been adjusted for insurers that prepare their financial statements on a basis other than NAIC Statutory Accounting Principles (SAP).

There are several differences between SAP and GAAP, including differences in presentation. State regulators utilize financial analysis tools and risk-based capital (RBC) standards to evaluate the financial condition of insurance companies. The benchmarks for these tools are based on SAP. Since most states do not require RRGs to follow the same accounting principles when preparing their financial reports, the results may not be as meaningful or reliable and may even be misrepresented because the tools are attempting to utilize financial data reported under GAAP, modified SAP and modified GAAP. Additionally, most RRGs formed as captives are not required to comply with the NAIC's RBC requirements or the insurance holding company statutes, which can affect the traditional methods used to assess the financial condition of an insurer. However, for some well-established RRGs, RBC requirements may be a useful analytical tool to assess growth and stability. As RRGs are different than traditional insurers, there are unique considerations that examiners should employ when implementing the risk-focused examination process. In addition to the standard seven-phase risk-focused exam process, some additional guidance focused on RRGs is included within this section for examiner consideration and use. For any areas not specifically discussed below, examiners should complete the RRG exam in accordance with the standard seven-phase risk-focused guidance.

B. Examination Coordination

As RRGs are usually licensed in a single state and are typically not part of a holding company structure involving other insurers but are often doing the majority of business in states other than their state of domicile, regulatory coordination

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may be appropriate. Generally, examinations of RRGs are performed solely by the domiciliary state. The domiciliary state should notify other states that an exam is being conducted by calling it through the Financial Exam Electronic Tracking System (FEETS). While this notification does not invite other states to participate on the examination, it will allow states in which the RRG conducts business to contact the domestic regulator with any questions or concerns they would like addressed by that domestic regulator during the examination and to participate in the exam as the domestic regulator deems appropriate. The LRRA only permits other states to conduct an exam if the domestic state has not begun an examination or refuses to conduct an examination, as long as that examination is coordinated to avoid unjustified duplication and repetition. Use of this exam coordination process should reduce the need for other states to conduct their own exams. Non-domiciliary states generally should not conduct their own exams if the domestic regulator has conducted a regular examination, and has reasonably exercised its discretion in deciding not to perform an unscheduled examination. Upon completion of the examination, the domiciliary state is required to distribute the completed examination report to all states in which the RRG is conducting business. As a best practice, the domiciliary state should also share the management letter, if any, with the other states in which the RRG conducts business.

C. Risk-Focused Examination Considerations

Although RRGs are unique in both size and reporting, they are still required to be subjected to the risk-focused surveillance process. There are some areas that will require modification to the risk-focused examination process; however, in general, the examination of an RRG should be very comparable to that of a standard insurer.

For an examination of an RRG, examiners should gain an understanding of the company, as required in Phase 1. Based upon that understanding, the examiner should identify the key functional activities of the RRG. Within Phase 1, the examiners are expected to assess the corporate governance of an insurer, as well as conduct management interviews. This must be completed for all insurers, including RRGs; however, there may be some unique considerations with regard to these procedures as discussed below.

After the key functional activities have been identified as part of Phase 2 procedures, the examiner would identify and document the inherent risks of the RRG. The examiners should then utilize professional judgment to assess the inherent risk by determining the likelihood of occurrence and magnitude of impact to obtain the overall inherent risk assessment for each identified risk.

Phase 3 requires the examiner to identify and evaluate controls in place to mitigate inherent risks. As with small insurers, many RRGs will not have extensive documentation surrounding internal controls. Examiner considerations in regard to identification and testing of controls for RRGs is discussed below.

The remainder of the RRG exam (Phases 4–7) should follow the general guidance for risk-focused exams as outlined in Section 2 of this Handbook.

1. Corporate Governance Assessment

   Although all RRGs have a board of directors, the sophistication and involvement of the board will vary from entity to entity. Exhibit M – Understanding the Corporate Governance Structure may be a useful starting point for examiners to gauge the involvement of the board. However, all of the information in Exhibit M may not be applicable, as described below.

   Independence of the board is something that examiners should consider when examining an RRG. As a best practice, the majority of the board of directors should be independent; however, for RRGs, independence may be achieved as long as the member has no material relationship with the RRG. A material relationship of a person with the risk retention group includes, but is not limited to:

   a. The receipt in any one 12-month period of compensation or payment of any other item of value by such person, a member of such person's immediate family or any business with which such person is affiliated from the risk retention group or a consultant or service provider to the risk retention group is greater than or equal to five percent (5%) of the risk retention group's gross written premium for such 12-month

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period or two percent (2%) of its surplus, whichever is greater, as measured at the end of any fiscal quarter falling in such a 12-month period. Such person or immediate family member of such person is not independent until one year after his/her compensation from the risk retention group falls below the threshold.

b. A relationship with an auditor as follows: a director or an immediate family member of a director who is affiliated with or employed in a professional capacity by a present or former internal or external auditor of the risk retention group is not independent until one year after the end of the affiliation, employment or auditing relationship. A relationship with a related entity as follows: a director or immediate family member of a director who is employed as an executive officer of another company where any of the risk retention group's present executives serve on that risk retention group's board of directors is not independent until one year after the end of such service or the employment relationship.

c. For this purpose, any person that is a direct or indirect owner of or subscriber to the risk retention group (or is an officer, director and/or employee of such an owner and insured, unless some other position of such officer, director and/or employee constitutes a material relationship), as contemplated by Section 3901 (a)(4)(E)(ii) of the LRRA, is considered to be independent.

The board of directors for many RRGs is composed of a select group of insureds (e.g., doctors, lawyers, etc.) which may not have extensive knowledge of, or experience in, the insurance industry. Many of the RRGs whose boards are set up in this manner place strong reliance on service providers to impart the expertise necessary to run an RRG; however, the board must still be able to provide appropriate guidance to those service providers, as they are ultimately accountable for the business conducted.

For those RRGs that place strong reliance on service providers, examiners should consider the competencies, experience, and results of those service providers as part of the corporate governance assessment. It may be necessary to meet with the service providers to obtain an overview of their general functions and responsibilities and to determine the type and frequency of interaction with the RRG board of directors.

With regard to service provider contracts, the term of any material contract with the risk retention group should not exceed five (5) years. Any such contract, or its renewal, should require the approval of the majority of the risk retention group's independent directors. The risk retention group's board of directors or its owners/insureds should have the right to terminate any service provider, audit or actuarial contracts at any time for cause after providing adequate notice as defined in the contract. The service provider contract is deemed material if the amount to be paid for such contract is greater than or equal to five percent (5%) of the risk retention group's annual gross written premium or two percent (2%) of its surplus, whichever is greater.

a. For purposes of this standard, "service providers" should include captive managers, auditors, accountants, actuaries, investment advisers, lawyers, managing general underwriters or other parties responsible for underwriting, determining rates, collecting premiums, adjusting and settling claims and/or preparing financial statements. Any reference to "lawyers" in the prior sentences does not include defense counsel retained by the risk retention group to defend claims, unless the amount of fees paid to such lawyers are "material" as referenced above.

b. No service provider contract meeting the definition of "material relationship" referenced above should be entered into unless the risk retention group has notified the commissioner in writing of its intention to enter into such transaction at least 30 days prior thereto and the commissioner has not disapproved it within such period.

Additionally, the RRG's board of directors should have a written policy in the bylaws that requires the board to:

a. Ensure that all owners/insureds of the risk retention group receive evidence of ownership interest.

b. Develop a set of governance standards applicable to the risk retention group.

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c. Oversee the evaluation of the risk retention group's management.

d. Review and approve the amount to be paid for all material service providers.

e. Review and approve, at least annually:

(1) The RRG's goals and objectives relevant to the compensation of officers and service providers.

(2) The officers' and service providers' performance in light of those goals and objectives.

(3) The continued engagement of the officers and material service providers.

Although there are some deviations from the standard exam procedures for RRGs, the exam team should still document its understanding and assessment of the entity's governance, as well as its assessment on the related impact on the examination as required in Exhibit M. If there are deficiencies identified, the exam team should make corresponding recommendations to management and the board.

2. Conducting Interviews

The structures of RRGs vary widely from company to company. Generally, there are three different categories of RRGs with regard to the type of inquiries to be made during the interview process: large RRGs set up and functioning like a typical insurance company, smaller RRGs that place significant operational responsibilities with a service provider, and smaller RRGs that perform in-house the significant operational responsibilities of the RRG.

For those larger RRGs that function similar to a standard insurance company, it is recommended that the examiner utilize Exhibit Y – Examination Interviews to assist with conducting interviews.

For those RRGs placing significant reliance on service providers, it will be necessary for the exam team to perform inquiries of both the RRG and the service providers. Some of the topics that should be covered with the RRG are as follows:

- Frequency and content of communications with the service provider.
- RRG monitoring of service provider controls (e.g., SOC Reports, review of controls, etc.).
- Compliance with service provider agreement.
- If applicable, implications of related-party service provider transactions.

In addition to the topics covered with the RRG, the examiners should discuss the following topics with the service providers:

- Frequency and content of communications with the RRG.

Experience and qualifications with regard to operations of an RRG.

- Compliance with service provider agreement.
- If applicable, implications of related-party service provider transactions.
- Availability of documented, effective, functioning controls (e.g., SOC Reports, internal documentation, etc.).

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- Functional activities performed along with related controls (e.g., underwriting, premiums, reserving, claims handling, etc.).

Additional considerations and questions that may be asked of the service provider can be found in the "Sample Interview Questions for a Captive Manager and/or Other Contracted Parties" section of Exhibit Y.

For those RRGs performing operations in-house, interviews are crucial to ensure that the examiner has a full understanding of what processes are being carried out and how they are being carried out. For RRGs that fall into this category, the examiners should inquire regarding:

- Experience and qualifications of employees with regard to operations of an RRG.
- Risks faced by the RRG and the RRG's responses to such risks.
- Conduct and ethical practices of the RRG.
- Availability of documented, effective, functioning controls.
- Functional activities performed along with related controls (e.g., underwriting, premiums, reserving, claims handling, etc.).

Interviews should not be limited to the topics listed above. Examiners should customize their interview agendas, as each RRG is unique. Additional interview topics examiners may want to consider are included in Exhibit Y – Examination Interviews.

3. Consideration of Information Technology (IT) Risks

Consideration should be given to the information technology used by all insurers, including RRGs. In Section 1 of this Handbook, a six-step General IT Review process is described that, along with the Exhibit C – Evaluation of Controls in Information Technology work program, should be utilized on all examinations. For RRGs that do not maintain any significant automated accounting functions, it may not be practical to conduct an in-depth review of the IT function; however, as the Exhibit C work program allows for extensive customization to meet the needs of each IT review, it should be modified and used regardless of the depth of review. The modifications to Exhibit C would eliminate any IT risks that are not of concern for the RRG under examination. This could substantially reduce the extent of the IT review; however, examiners do need to keep in mind that each section of COBiT should be reviewed, in general, and findings from the IT review impacting reliance that can be placed on the IT function must be identified.

4. Identification and Testing of Controls

As with any examination, the identification and testing of controls may be accelerated in order to examine the insurer in the most effective and efficient way possible. However, as the risk-focused surveillance approach within this Handbook is a set process, examiners must still document an understanding of controls. As many RRGs are small companies, it is recommended that examiners utilize the guidance for small-to-medium-sized insurers as described in Section 2.

For those RRGs that rely extensively on service providers to perform the key functional operations, the examiner should seek to obtain a SOC 1 report for the service provider and ensure that the RRG is adhering to the user control considerations listed in the report. If no SOC report is available, it may be necessary for the examiners to go on-site at the service provider to review the controls in place. This on-site control review will allow the state to determine the adequacy of controls in order to gain evidence about the ongoing solvency of both the service provider and the RRG. For any control issues noted, the examiner should provide control recommendations to benefit the RRG.

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For areas of the risk-focused exam process that were not affected by the RRG-specific considerations discussed above, examiners should utilize the general risk-focused exam guidance in Section 2 to complete the RRG examination.

An RRG-specific repository is available on the NAIC website and may be useful to examiners in conducting examinations of RRGs.

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VIII. SPECIAL CONSIDERATIONS FOR TITLE INSURERS

This section covers procedures and considerations that are important when conducting financial condition examinations of title insurers. The discussion here is divided as follows:

A. Title Insurance Overview
B. Differences from Property and Casualty Coverage
C. Key Title Insurance Risk Areas
    1. Title Insurance Revenue
    2. Title Insurance Agents
    3. Statutory Premium Reserve
    4. Losses and LAE
    5. Reinsurance
    6. Title Plants
    7. Escrow

A. Title Insurance Overview

Title insurance provides coverage in the event of an impairment of the title at the time of the transfer of property. The term of the policy is indefinite in that the policyholder is insured for as long as he, his heirs or devises have an interest in the property. Title insurers perform many services in connection with these transfers, including insuring, guaranteeing, or indemnifying owners of real estate or the holders of liens or encumbrances thereon against loss or damage suffered by reason of defective titles, liens or encumbrances or, in most states, the unmarketability of the title. The principal purpose of title insurance is to facilitate the sale of property by providing coverage to the lenders (lenders policy), but coverage can also be provided for the buyer of the property (owner's policy). Lender policies specifically protect mortgage lenders from costs and losses stemming from defects in title on properties for which they hold the mortgage. Policy face values are for the total value of the mortgage loan only, and coverage decreases as the loan is paid off. Owner's title insurance, on the other hand, usually covers a property's total purchase price (not just the mortgage).

Title insurance business is produced through four basic venues: direct residential, national lender, direct commercial and agency. Direct residential, national lender and direct commercial have the most fixed costs, as title insurers that market through those channels do their own marketing and bear the costs of underwriting the policies. These may be considered captives, as their operations are controlled by the insurers. In the agency channel, title insurers' cost structure is much more variable because of the commission structures paid to the title agents. The agency is independent of the title insurer and may, in fact, represent more than one insurer. Title agents generally handle all aspects of real estate closings, such as securing loan payoffs and funding; disbursing monies to sellers; paying for appraisal, home inspection and other service fees; paying property insurance premiums; producing closing documentation; and recording documents with local governments. Given these responsibilities, title agents often manage significant amounts of money, of which only a portion is related to the business of title insurance.

B. Differences from Property and Casualty Coverage

The primary emphasis in property and casualty insurance is to provide indemnity for events over which, at least in theory, neither the policyholder nor the insurance company has any control. In contrast, title insurance is a business of loss elimination, which identifies or eliminates risk before issuing a policy. Title searches are done not to provide indemnification of defects in title, but to try to make sure that there are no unknown defects in title at the time of transfer. In theory, if title searches were done perfectly, title policies issued for "on the record" items would have no losses. In practice, there are errors in title searches, errors in escrow operations, and "off the record" items, such as mechanic's liens, that can cause title claims.

In property and casualty insurance, the bulk of the premium dollars go to pay claims. As a result, the profitability of a property and casualty line is mainly due to the loss and loss adjustment expense ratios. The title industry's cost structure differs substantially from that of property and casualty insurers. In title insurance, the bulk of the premium dollars go to the costs of maintenance of title databases called title plants, title searching costs, agent commissions, and other costs of

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administration. Title insurers have relatively high fixed costs. As a result, profitability for title insurers is much more related to the volume of title business than to loss expenses.

C. Key Title Insurance Risk Areas

1. Title Insurance Revenue

The variety of services performed by a title insurance company in connection with the insurance of a real estate title may vary substantially according to local statutes, regulations or practices. This causes a substantial variance in the classification of these services on financial statements of title insurers. While these services are an integral part of the transfer of title to real estate, services may be performed by title insurance companies separately in competition with title insurance agents, or insurers may subcontract some functions to agents or others.

When title insurance companies perform these services, it is often not possible to allocate specific revenue or costs to a separate function such as search, examination, closing, or escrow services with any precision. Many joint costs of the insurer cannot be adequately allocated to a specific function and some functional elements of title insurance costs tend to overlap into other areas (e.g., a portion of search and escrow costs performed by a title insurance company could be partially allocated to an underwriting function).

The amount of title insurance premiums to be reported by premium rate type shall be guided by the following definitions of the methods of reporting "Direct Premiums Written":

> Gross All-Inclusive Premiums – Under this method of reporting direct premiums written, the title insurer and its title agent generally perform all the functions necessary to insure the risk and to issue a title insurance policy. The title insurer reports 100% of the premiums charged either through its branch office or its title agents. Direct premiums written reported under this method generally contemplates some or all of the following factors in the rate-making process: cost of title search and examination, policy issuing cost, amount retained by agents/abstracters/attorneys, overhead and miscellaneous expenses, expected losses and LAE from underwriting the risk, profit margin, and additional activities (such as closing).
>
> Gross Risk Rate Premiums – This method of reporting direct premiums written generally applies to states where either by statute or custom the charge for title search and examination are excluded or charged for separately from the title insurance premiums. The cost factors contemplated in the rate-making process include the proportionate share of all of the factors listed in the "Gross All-Inclusive Premiums" except the cost of the title search and examination.

2. Title Insurance Agents

Unlike agents representing other lines of insurance whose primary function is to sell the policy and receive a sales commission, title insurance agents also perform various functions in connection with the issuance of a title insurance policy. These functions can include search and examination, abstracting, and certain underwriting and closing services. Typically, the agent collects the entire charge for the title insurance transaction, retains a portion for his services, and forwards the insurer's portion in accordance with individual agency contracts.

3. Statutory Premium Reserve

Since title insurance premiums are fully earned on the date of policy issuance, there are no unearned premiums for title insurers. Most states require title insurance companies to establish and maintain a statutory premium reserve. Generally, the title insurance company must establish this statutorily required deferred income account based upon the law of its domiciliary state. The computation is based upon either premium revenue, number of policies issued, liability assumed, or combinations thereof. The reserve is drawn down in accordance with recovery or amortization formulas as prescribed by state law. Title insurers are required to report a reserve (including losses and loss adjustment expenses) for known claims, but are not required to book a separate reserve for incurred but not reported (IBNR) claims. The purpose of the Statutory Premium Reserve is to provide funds to pay for IBNR claims.

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4. Losses and LAE

Title insurance losses should include all losses on any transaction for which a title insurance premium, rate or charge was made or contemplated. Escrow losses for which the company is contractually obligated should be included. Losses arising from defalcations for which the company is contractually obligated should also be included.

Unlike most other forms of insurance, losses do not generally represent the largest liability or expense for title insurance companies. The emphasis is upon loss prevention and the duty to defend, rather than on reimbursement of losses. Therefore, title insurance companies incur large expenses in labor, equipment, etc., in maintaining title records, in searching and examining the titles to real estate, in curing defects found prior to the issuance of the policy, and closing or escrow services. The liability for unpaid losses is composed of 1) the case reserve, net of recoveries, for undetermined title and other losses of which notice has been received (known claims reserve); 2) the statutory premium reserve; and 3) the excess of Schedule "P" reserves over statutory reserves (supplemental reserve).

The known claims reserve (referred to as the "loss reserve for undetermined title and other losses of which notice has been received") is the amount estimated to be sufficient to cover all unpaid losses, claims and allocated loss adjustment expenses arising under title insurance policies; guaranteed certificates of title; guaranteed searches and guaranteed abstracts of title; and all unpaid losses, claims and allocated loss adjustment expenses for which the title insurer may be liable and for which the insurer has received notice by or on behalf of the insured, holder of a guarantee or escrow or security depositor. The known claims reserve may also include "bulk" reserves, if any - a provision for subsequent development on known claims. The reserve for known claims is generally determined using established reasonable baseline reserves developed by tracking and analyzing historical claims data. These estimates are reviewed and adjusted as necessary.

In addition to reserving for known claims, a title insurance company must also provide for losses that are IBNR and for unpaid ULAE in Schedule P. Various methods are used for estimating these reserves. Whatever methods are selected for establishing unpaid losses, the goal should always be reserve adequacy.

The Statutory Premium Reserve (SPR) is considered a liquidation reserve and is similar to a property and casualty company's IBNR reserve. The SPR is intended to provide a reserve for IBNR losses and unallocated loss adjustment expenses on all claims.

The supplemental reserve is the excess, if any, of Schedule "P" reserves over statutory reserves (i.e., the excess of the known claims reserve + IBNR reserve + ULAE reserve [total Schedule "P" reserves] over the known claims reserve + SPR [statutory reserves]).

Salvage and subrogation should be reflected using the following rules:

a) Paid losses must be reported net of realized, but not anticipated, salvage and subrogation. Case basis loss and loss adjustment expense reserves must not be reduced on account of anticipated salvage and subrogation.

b) Paid salvage and subrogation is not realized until a salvage asset or an actual payment pursuant to a subrogation right is in the direct control of the insurer and is admissible as an asset for statutory reporting purposes in its own right.

c) Salvage assets and payments pursuant to a subrogation right are to be booked at current market value. Current market value of real estate is to be established through an appraisal conducted by a qualified independent appraiser.

d) IBNR reserves may make a provision for the expected value of future salvage and subrogation on open claims and IBNR claims. This provision must be actuarially determined and should not be based upon current case estimates.

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5. Reinsurance

Many states have limitations as to qualifications of insurers relating to single-risk liability on risks issued on property in that state. Where these limitations are applicable to a policy, reinsurance is purchased, reducing the ceding company's net retained liability for the risk ceded. Title insurance utilizes two main types of reinsurance. The most common type is facultative reinsurance that pertains to one individual, particular risk or transaction. The ceding company may offer all or any part of a risk to one or more other title insurers or reinsurers who may either accept or reject that particular risk. The facultative reinsurance agreements utilized in the title industry have been developed by the American Land Title Association. Facultative reinsurance allows some flexibility in the spreading of the risk in which the ceding company normally retains the primary risk and the remaining risk is ceded to the assuming reinsurer.

The other type of reinsurance utilized in the title industry is called treaty reinsurance. This is usually done on an excess of loss basis where a treaty contract is negotiated and the ceding company is indemnified against loss in excess of a specified retention, normally subject to a specified limit, with respect to each risk covered by the treaty.

6. Title Plants

Title plants are an integrated and indexed collection of title records covering parcels of real estate within a county. They are tangible assets unique to the title insurance industry and are the principal productive asset used to generate title insurance revenue. Title plants consist of documents, maps, surveys, or entries affecting title to real property or any interest in or encumbrance on the property, which have been filed or recorded in the jurisdiction for which the title plant is established or maintained.

Title insurers are authorized to invest in title plants and to classify them as admitted assets in their financial statements subject to valuation restrictions which vary from state to state. Insurers' investments in title plants are detailed in Schedule "H" of the annual statement.

7. Escrow

Title insurers provide services in which they have custody and are accountable for cash and other assets belonging to others. Generally these services relate to real estate settlement services, in which closing "escrow" funds are received and disbursed, and note and contract collection services, in which payments of principal and interest are received and disbursed. In addition, title insurers may hold cash or other assets as security for indemnity agreements with the company and others relating to title matters.

These "custodial" funds are set apart in special accounts and are excluded from title insurers' assets and liabilities in the statutory statement. However, the title insurer's accountability for these "custodial" funds is reported in a footnote, and the details of segregated deposits of these funds in banks, trust companies, and savings and loan associations are reported in Schedule "E" of the annual statement.

An examination repository with specific risks related to title insurance is available on the NAIC website and may be useful to examiners in conducting examinations of title insurers.

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IX. SPECIAL CONSIDERATIONS FOR SEPARATE ACCOUNTS

This section covers procedures and considerations that are important when conducting financial condition examinations of insurance companies that maintain separate accounts. The discussion here is divided as follows:

A. Background
B. Contingent Liabilities and Reserves
C. Asset Valuation
D. Prospective Risks

A. Background

Separate accounts are segregated pools of assets owned by life/health insurers and fraternal benefit societies. Separate accounts are not separate legal entities, but rather accounts segregated from the company's general account, and from other separate accounts, established to support certain contracts, in whole or in part. The assets are owned by the insurer and the insurer is not a trustee by reason of the insurer's establishment of a separate account to support specified contract liabilities. State statutes provide that separate account assets may generally be invested and reinvested without regard to the requirements or limitations imposed upon an insurer by the investment statutes applicable to insurers.

These accounts were initially established to isolate products and assets in which the contract holder assumed the investment risk. More recently, separate accounts have supported a broader range of contract liabilities, including contracts with more limited transfer of the investment risk to contract holders. The flexibility they offer policyholders has been one of the driving forces behind their expanded use. Separate accounts may be used to fund a variety of products, including individual and group, fixed and variable, guaranteed and non-guaranteed, life insurance and annuities. The types of products included in separate accounts can differ by state, and attention should be paid to specific state statutes governing these accounts. Requirements within each state may also change, creating potential compliance issues for products impacted by these changes. This expanded use creates the potential for greater risk to the general account. For example, guarantees on separate account products improperly managed or accounted for may create concerns for the overall solvency of the general account. Therefore, the increased use of guarantees results in a greater need for scrutiny of separate accounts in the examination process.

The concept of the separation of assets from the general account is also reflected in GAAP accounting rules. Therefore, an understanding of these rules can highlight variances in treatment of separate account contracts and the related risks. GAAP rules require the following four conditions for separate account reporting:

1) The separate account is recognized legally.
2) The assets supporting the contract liabilities are insulated legally from the general account liabilities and the contract holder is not subject to insurer default risk to the extent of the assets held in the separate account.
3) The funds are invested as directed by the contract holder in designated investment alternatives or in accordance with specific investment objectives or policies.
4) All investment performance, net of contract fees and assessments, is passed through to the individual contract holder. (Under this requirement, there could be a minimum guarantee, but not a maximum investment return, to the contract holder.)

Although other risks exist for companies that allocate and report products in separate accounts in accordance with GAAP requirements, the contract holder bears the investment risk. Therefore, the risks associated with these separate accounts may differ from separate account products that do not qualify for GAAP reporting.

Accounting for contracts supported in whole or in part by separate accounts may involve both the general account of the insurer and the separate accounts. The separate accounts annual financial statement is concerned primarily with the investment activities of the separate accounts and with the flow of funds from and to the general account. Only direct investment transactions (purchase; sale, including profit and loss thereon; income; and direct expenses and taxes relative to specific investments) are recorded as direct transactions in the separate accounts annual financial statement. All other

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transactions are reported as transfers between the general account of the insurer and the separate accounts statements. In general, the separate accounts do not maintain surplus. Rather, gain or loss from separate accounts is transferred to the general account each year. The statutory accounting treatment for separate accounts can be found in *SSAP No. 56—Separate Accounts.*

The guidance contained here assumes the standard treatment for separate account assets and their related liabilities is applied as outlined in SSAP No. 56 and the *Variable Contract Model Law* (#260). However, under certain circumstances, Model #260 allows alternative accounting treatment with the approval of the domiciliary insurance commissioner. Examiners should take into consideration any special approvals and revise the risks and related procedures accordingly.

B. Contingent Liabilities and Reserves

There are a variety of products supported in full or in party by separate accounts and it is important to understand the risks that these contracts pose to the company. For some separate account products, the entire investment risk is absorbed by the policyholder and the general account does not participate in any investment gains or losses incurred. However, other types of separate account products include guarantees such as minimum death benefits, minimum interest rates or bailout surrender charge provisions. SSAP No. 56 provides guidance for the allocations between the general account and the separate account and any minimum guaranteed obligation is generally required to be recorded on the general account of the insurer. Because these types of products create the potential for risks to the general account, examiners should be aware of this risk and appropriate steps should be taken to include it in the examination process. Product features continue to evolve and it is important to obtain these from the insurer being examined. Some examples of contract types that may create contingent liabilities include the following:

- Variable Annuities with Guarantees or Living Benefits
- Modified Guaranteed Annuities
- Indexed Products
- Experience Rated Guaranteed Interest Contracts
- Fully Guaranteed Interest Contracts
- Funded, Experienced Rated Group Annuity
- Synthetic Guaranteed Interest Contracts

All liabilities, including any contingent liabilities, are required to be considered in setting the policy reserves. In the case of a variable contract without guarantees, the separate account holds all of the policy or contract reserves. In the case of a variable annuity contract that includes guarantees, the reserves supporting such guarantees shall be recorded and held in the general account under the reserving guidance in SSAP No. 56. This SSAP indicates that statutory policy reserves shall be established for all contractual obligations of the insurer arising out of the provisions of the insurance contract. Where separate benefits are included in a contract, a reserve for each benefit shall be established. There are reserve requirements applicable to other types of products and guarantees that should be reviewed during an examination. Specific guidelines and references to applicable NAIC models that may assist in this review are included in SSAP No. 56.

C. Asset Valuation

The assets included in separate accounts are generally carried at fair value, which could be materially different than the valuation of these same assets under statutory accounting. This difference can increase the risks for products in the separate accounts in cases where the reserve does not reflect the changes in asset value.

D. [illegible] Risks

Although the most common products supported by separate accounts transfer investment risk to the policyholder, this cannot be said for all products written by all companies. As specific contracts or policies may vary in the risks that may be borne by the insurer or the contract holder, it is not possible to identify all potential risks. Accordingly, the examiner should consider whether the reporting entity writes contracts with the potential for risks such as mortality, expense or other underwriting risks to be fully or partially borne by the insurer under different scenarios.

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An examination repository with risks specific to insurers with separate accounts is available on the NAIC website and may be useful to examiners in conducting examinations of these insurers.

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X. REPORTING EXAMINATION PROGRESS AND FINDINGS

This section provides some general guidelines on procedures in reporting examination progress and findings. The discussion here is divided as follows:

A. Interim Reporting to Chief Examiner
B. Interim Reporting by Examiners to their Respective Zones
C. The Report of a Full-Scope Examination
D. The Management Letter
E. The Report of a Limited-Scope Examination
F. Discussion of Report Findings with Company Officials
G. Preparation of Reports and Draft Reports for Participating Examiners
H. Coordination and Distribution of the Examination Report of a Multi-State Insurer and the Resolution of Report Conflicts
I. Timeliness of Examination Reports
J. Post-Examination Follow-Up Procedures

A. Interim Reporting to Chief Examiner

At intervals during the examination, not less than monthly, the examiner-in-charge should address a memorandum to the chief examiner (or designee) setting forth:

1. A status report of the examination, including, at a minimum, the following:

   a. A clear explanation of the examination's progress broken down by phase/key activity.
   b. A summary of time incurred by examiners including budget, actual and time remaining to complete.
   c. A summary of unusual problems, any significant issues identified throughout the examination and the examiner-in-charge's proposed resolution.
   d. Proposed changes to the approved budget.

2. Other requirements as may be set forth by each state's chief examiner.

B. Interim Reporting by Examiners to Their Respective Zones

The requirement of periodic status reports and their confidentiality will be determined on a zone basis.

If the zone determines that the examiner representing the zone is required to prepare and submit status reports on the progress of the examination, the following guidance is suggested. The reports shall include information on the progress made in addressing the concerns expressed by the zone when the examiner was assigned to the examination, any significant issues disclosed and proposed resolutions. The examiner-in-charge should be given the opportunity to comment and sign the status report; however, the signature of the examiner-in-charge does not necessarily convey agreement with the information disclosed in the status report. The responsibility for requiring the zone examiner to prepare and submit periodic status reports rests with each individual zone. Other states in the zone may request copies of the status reports from the zone secretary. However, the states should be aware that the issues disclosed in the status reports are preliminary in nature, and should not take action based on the preliminary findings.

C. The Report of a Full-Scope Examination

An examination report is required for each full-scope examination. Guidance has been provided within Phase 7 of the risk-focused examination process to assist in developing an examination report.

D. The Management Letter

In addition to including comments in the report, examiners should also make comments, where appropriate, within confidential management letters, or other means of communication, that can be used for both full-scope and limited-scope

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examinations. Potential or prospective risks may also be discussed in this communication. Guidance has been provided within Phase 7 of the risk-focused examination process to assist in developing this communication.

E. The Report of a Limited-Scope Examination

1. Definition and Purpose

The full-scope examination is just one of many tools available to state insurance departments to monitor the solvency of insurance companies. By definition, the full-scope examination is comprehensive and limitations on resources generally preclude performing a full-scope examination at frequent intervals. A limited-scope statutory examination is defined as an examination which is limited to a review or examination of particular risk areas with a known or suspected issue as determined on a basis other than the implementation and documentation of the risk assessment procedures within this Handbook. A limited-scope statutory examination will result in a Report of Examination, which may include a conclusion on the financial condition of the insurer, but the conclusion should note that it is based solely on work performed in the specific areas. All full-scope and limited-scope examinations performed must include an examination report. However, each state may determine on a per exam basis, if a limited-scope examination report should be considered confidential (e.g., a report containing information that might provide an unfair advantage to the company's competition). Completion of limited-scope examinations does not satisfy the five-year examination requirements of the NAIC accreditation program.

The purposes of a limited-scope examination are to review specific aspects of the company's financial or operational processes with known or suspected issues, to perform specific procedures with respect to those aspects, and to report as to the examiners' findings thereon. By definition, a limited-scope examination is less comprehensive than a full-scope examination and will focus on areas currently perceived by the department to be problem areas or potential problem areas. Consequently, the limited-scope examination report should provide specific information for any disciplinary or other regulatory action.

2. Format

The report of a limited-scope examination should be structured and written to communicate to regulatory officials the findings of specific areas reviewed. In many instances, a limited-scope examination report will be a follow-up to a finding of a recent full-scope examination. It may be appropriate to refer to the full-scope examination report for general background information about the company. However, with regard to the specific areas covered by the limited-scope examination, information should be provided to clearly set forth those areas, background as to why such areas are the subject of the report if not otherwise evident, a brief description of the procedures performed, and the examiner's findings.

Each report of a limited-scope examination should contain the following sections:

a. Table of contents (with contents and pages denoted).

b. Salutation.

c. An identification of the company, the date of the last full-scope examination that was performed at the company, and a description of the concerns that gave rise to the need for the subject limited-scope examination.

d. A disclosure that the report is a limited-scope examination, and is not intended to communicate all matters of importance for an understanding of the company's financial condition.

e. Scope of the examination, identifying those areas that were specifically reviewed and a brief description of the procedures performed. For example, a limited-scope examination could review specifically the collectability of certain reinsurance balances. The description of the procedures would not entail each and every step that was performed but would describe generally whether the procedures were limited to

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inquiry of company officials or included more substantive tests such as independent verification, confirmation with third parties or other procedures.

f. The examiners' findings should be presented, with an indication for each area examined that the issue or concern that gave rise to the need for the limited-scope examination has now been resolved, has yet to be resolved and its current status, and/or other information necessary for further regulatory action. Unlike a full-scope examination for which it is not necessary to comment on areas that do not result in significant adverse findings, a limited-scope examination report should include an affirmative statement, if such is the case, that no significant adjustments or adverse findings were identified for the area reviewed.

F. Discussion of Report Findings with Company Officials

Periodically, during an examination, it will be necessary for examiners to discuss tentative findings or other matters with company officials. Examiners are encouraged to initiate such discussions. However, discussions with company officials, except regarding minor matters, should be held only with the knowledge of the examiner-in-charge.

The purpose of discussions with company officials concerning report findings should be limited to assisting the examiners in ascertaining facts and in verifying the accuracy of the findings. Whenever the examiners have doubt as to the accuracy of an examination finding, they should give the company an opportunity to review the finding and the material supporting it.

G. Preparation of Reports and Draft Reports for Participating Examiners

Procedures adopted by the domestic state for the preparation and distribution of the report of examination are to be followed. All participating examiners shall be furnished a draft of the domestic state's exam report prior to leaving the assignment.

H. Coordination and Distribution of the Examination Report of a Multi-State Insurer and the Resolution of Report Conflicts

1. Where no controversy exists and the Report of Examination has been agreed upon and signed by the participating examiners and adopted by the domiciliary state, it shall be the duty of the said domiciliary state to distribute a copy of the Report of Examination to each of the states in which the company is licensed and/or transacting business by uploading the Report of Examination to the NAIC Financial Exam Electronic Tracking System (FEETS) no more than 30 days beyond the date the report is adopted. If a state requests a hardcopy of the examination report, such must be sent to the state in a timely manner.

2. If the participating examiners do not agree and cannot sign a unanimous report of examination, it shall then be the duty of the commissioner of the domiciliary state to call a conference with the commissioners of the states of the participating examiners in an effort to settle differences. If no agreement results from the conference, majority and one or more minority reports shall be made, and it shall then be the duty of the commissioner of the domiciliary state to distribute copies of the majority and minority reports to those states in which the company is licensed to transact business by uploading the report to FEETS.

3. In those instances in which the company under examination shall request a hearing on the report of examination, it shall be the duty of the commissioner of the domiciliary state to call a hearing in accordance with the laws of that state, request the attendance of the participating examiners, and invite the attendance of commissioners whose examiners participated in such examination including the respective zone secretaries; thereafter, the supervisory official of the home state shall notify, at least once each in 90 days (prior to the 18-month reporting date), the supervisory official of each participating state, the secretary of each participating zone and the chair of the Financial Condition (E) Committee, of the progress of the hearing and the reasons for any delay or postponement in the release of the examination report. Once the 18-month rule has been exceeded, this notification must occur at least every 30 days.

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4. If the report of an examination of a multi-state insurer is not released within three months after completion and signature by a majority of the participating states, the zone secretary of any state participating in the examination may make such report, or any part thereof, available to the individual states in his or her zone.

5. When an examination has been called that covers a group of companies, the examination reports of the companies in the group are to be handled in accordance with subparagraph 1 above. If sufficient evidence has been obtained from the group examination to support the conclusions contained within an individual examination report, its issuance should not be delayed only because the examination of the remainder of the companies in the group has not been completed.

I. Timeliness of Examination Reports

In an effort to make the report of examination a relevant and useful document to regulators and the public, it must be issued on a timely basis. An exam report should be dated as of the last day of fieldwork. The last day of fieldwork (also known as the report date) is defined as the date that the examiner is confident that sufficient evidence has been obtained to support the contents of the examination report. Sufficient evidence that should be obtained through this date includes completion of exam testing, review of subsequent events and receipt of the management representation letter. The report should be filed no later than 120 days after the report date or within a time period as defined within state statute. If the report is not filed within 120 days, additional procedures to "roll forward" the report date should be performed, including updating the review of subsequent events and obtaining a new management representation letter that is effective through the report date. A report of examination is considered "filed" when the commissioner or commissioner's designee enters an order adopting the examination as filed or otherwise made final as required by law or regulation. A report of examination must be filed no later than 18 months after the "as-of" examination date, except under extenuating circumstances such as those described below. Examiners are also encouraged to adhere to this timeliness requirement for reports of examination of non-accredited single-state insurers.

The circumstances described below are not meant to be all-inclusive, but they describe common scenarios encountered by regulators. Although other circumstances may exist that meet the spirit of this guidance, those circumstances must be based on specific facts and must be well-documented. None of the permissible exceptions described below should be interpreted as a general regulatory practice, but are to be utilized only as exceptions under challenging circumstances.

A report of examination may be filed more than 18 months after the "as-of" examination date if the chief examiner has formally communicated the reasons for not filing the report of examination within 18 months, including a status report on all material findings, to the other states in which the insurer is licensed and has documented one or more of the following circumstances:

1. Fieldwork was completed and a draft report of examination was available within the 18-month period, but due to regulatory action that is pending by the commissioner based on the examination findings, the report of examination was not filed within the 18-month period. The regulatory action must be a corrective action plan, or equivalent regulatory action, supervision, conservation, rehabilitation or liquidation. If regulatory action is pending beyond 19 months from the "as-of" examination date, the report of examination should be filed in accordance with state statute, but not later than 22 months from the "as-of" examination date. If a report of examination is not filed within 22 months from the "as-of" date, and the commissioner has commenced proceedings to place the insurance company into court-ordered supervision, conservatorship, or receivership, no report of examination is required to be filed. In these scenarios, the commissioner is deemed to be in control of the insurer's operations and a formal filing of the report of examination is not necessary. Upon the company's release from the court-ordered supervision, examinations should be conducted in accordance with state requirements. Documentation of the above actions should be included in the chief examiner's files or supporting workpapers. In lieu of filing the report of examination within 22 months from the "as-of" date, the commissioner or the chief examiner can reopen the examination and "roll forward" the financial examination to a more current "as-of" date. The decision to "roll forward" an examination should be based on reasons so significant that the issuance of an examination report with the original "as-of" date would be irrelevant or misleading, and such decision should be extensively documented. The "roll forward" of the examination must be completed within the existing statutory examination requirements of the state.

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2. Fieldwork was completed and a draft report of examination was submitted to the insurance company under examination by the 18th month, but based on "due process" in accordance with state law or regulation (e.g., the company has asked for a hearing on the report), no report of examination was filed by the 18th month. In such cases, the report of examination must be filed no later than 22 months from the "as-of" date.

3. Fieldwork is completed and a draft report of examination does exist by the 18th month. However, it can be demonstrated that the Department has met with senior company management on material examination issues and a formal plan (e.g., restructuring effort, raising additional capital) is under development. In such cases, the report of examination must be filed no later than 22 months from the "as-of" date. In lieu of filing the report of examination within 22 months from the "as-of" date, the commissioner or the chief examiner can re-open the examination and "roll forward" the financial examination to a more current "as-of" date. The decision to "roll forward" an examination should be based on reasons so significant that the issuance of an examination report with the original "as-of" date would be irrelevant or misleading, and such decision should be extensively documented. The "roll forward" of the examination must be completed within the existing statutory examination requirements of the state.

4. Fieldwork is not completed primarily due to the insurer's lack of cooperation or lack of adequate response. The workpapers and report of examination must document the lack of cooperation by the company. The workpapers shall also contain timely communication to the commissioner and/or their designee and chief examiner about the lack of cooperation. A plan and timeline shall be developed by the department and implemented before the 18th month to mandate the company's full cooperation. In such cases, the report of examination must be filed no later than 22 months from the "as-of" date.

5. In coordinated financial examinations, it is common for states that participate in coordinated examinations to rely on examination work performed by another state. When a participating state determines that it will be unable to file its report of examination within 18 months from the "as-of" examination date, and this is caused by the other state's failure to complete field work on material examination areas, the participating state must develop an appropriate course of action to enable it to complete its financial examination and file its report of examination. The participating state may need to consider expanding its scope or level of participating to enable it to complete its financial examination. The participating state should document its overall assessment of the other state's examination conduct, and its report of examination must be filed no later than 22 months from the "as-of" date.

6. Natural disasters or other extraordinary events or circumstances could, in extreme cases, delay the issuance of the report of examination. Each event should be considered individually. A reasonable extension of time for filing a report of examination should generally correlate to the length of time the examiners were unable to report to work or were unable to locate information necessary to complete fieldwork. In some situations, it may be necessary to cancel the current examination and reschedule to a subsequent period or roll the current examination forward to the subsequent period.

In the event that an exam report of a multi-state insurer has not been issued after 22 months, the Examination Oversight (E) Task Force must be notified of the delay within 10 days of the end of the 22nd month. As part of this notification, the Task Force should be provided with a detailed explanation as to why the report has not yet been completed and a description of an action plan for completing the report. Once this information is received, the Task Force will review the information and determine whether to exercise its authority to recommend a special E Committee examination. If the Task Force identifies a potential solvency issue during this process, the issue will be referred to the Financial Analysis (E) Working Group for consideration.

Communication with Other State Regulators

With the exception of a company under examination that is placed in formal receivership, conservation, or liquidation, the chief examiner must formally communicate the reasons for not filing the report of examination within 18 months, including a status report on all material findings, to the other states in which the insurer is licensed or transacting business. The chief examiner must initially communicate to other states no later than 30 days following the 18th month after the "as-of" date, and must continue to do so on a monthly basis until the report of examination is formally filed. The

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notification should include the status of the examination, reason(s) for delays, comments regarding exam findings and the company's financial condition and anticipated filing date. Reasons for examination report delays should be contemporaneously documented in writing in the chief examiner's files or supporting workpapers. These files should be readily accessible.

Unless agreed upon otherwise, all communication between states is with an understanding that any examination information reported by the chief examiner, or examination documentation provided by the chief examiner, will be kept confidential by the states that receive it.

J. Post Examination Follow-Up Procedures

The effectiveness of the examination system would be enhanced if effective follow-up procedures were instituted by the home state insurance department. Periodically, after the report has been submitted, inquiries should be made to the company to elicit the extent of corrective action, not otherwise known, on report recommendations and criticisms. The timing and extent of these inquiries or other follow-up action may be determined based upon recommendations of examiners during a full-scope or limited examination. A lack of satisfactory corrective action by the company may be cause for consideration of official proceedings against the directors and officers.

An important aspect of the examination process is the recommendations by the examiners regarding areas of the company that should be scheduled for further follow-up action or review by the department, such as conducting limited-scope examinations, written correspondence between the department and the company, meetings between the department and the company, and other necessary actions including updating the supervisory plan, supervisory review memorandum, and/or the insurer profile summary.

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XI. REVIEWING AND UTILIZING THE RESULTS OF AN OWN RISK AND SOLVENCY ASSESSMENT

This section of the Handbook provides general guidance for use in reviewing, assessing and utilizing the results of an insurer's confidential Own Risk and Solvency Assessment (ORSA) in conducting risk-focused examinations. Therefore, this guidance may be used in support of the risk management assessments outlined in other sections of the Handbook (e.g., Phase 1, Part Two: Understanding the Corporate Governance Structure, Exhibit M – Understanding the Corporate Governance Structure) at the discretion of Lead State examiners.

A. Background Information
B. General Summary of Guidance for Each Section
C. Review of Section I – Description of the Insurer's Risk Management Framework
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A. Background Information

The NAIC's *Risk Management and Own Risk and Solvency Assessment Model Act* (#505) requires insurers above a specified premium threshold, and subject to further discretion, to submit a confidential annual ORSA Summary Report. The model gives the insurer and insurance group (hereinafter referred to as "insurer" or "insurers" throughout the remainder of this guidance) discretion as to whether the report is submitted by each individual insurer within the group or by the insurer group as a whole. (See the *NAIC ORSA Guidance Manual* for further discussion.)

There is no expectation with respect to specific information or specific action that the Lead State regulator is to take as a result of reviewing the ORSA Summary Report. Rather, each situation is expected to result in a unique ongoing dialogue between the insurer and the Lead State regulator focused on the key risks of the group. For this reason, as well as others, the Lead State analyst may want to consider including the Lead State examiner or any other individual acting under the authority of the commissioner or designated by the commissioner with special skills and subject to confidentiality that may be of assistance in their initial review of the ORSA Summary Report in possible dialogue with the insurer since the same team will be part of the ongoing monitoring of the insurer and an ORSA Summary Report is expected to be at the center of the regulatory processes. A joint review such as this prior to the Lead State analyst documenting his or her summary of the ORSA report may be appropriate.

After participating in the initial review of information provided in the ORSA Summary Report, the Lead State examiner is expected to incorporate a review of ORSA information into ongoing on-site examination activities. Examiners are reminded that ORSA information is highly sensitive, proprietary and confidential, and examiners should exercise caution to ensure that no ORSA or ORSA-related materials are inadvertently made public in any way, including in any Exam Report. Depending upon the examination schedule or cycle, the Lead State examiner may consider performing a limited-scope exam to conduct on-site examination activities related to ORSA information on a timely basis. In incorporating a review of ERM/ORSA information into financial exam activities, the Lead State examiner should seek to utilize existing resources to avoid duplication of efforts and provide exam efficiencies.

In cases where one insurer provides an ORSA Summary Report, the domestic state is responsible for verifying, assessing and utilizing the information received to facilitate and gain efficiencies in conducting on-site examinations. In cases where a group of insurers provides an ORSA Summary Report (or multiple legal entities within an insurance group provide separate ORSA Summary Reports), the Lead State is expected to coordinate the review, assessment and utilization of the information received to facilitate and gain efficiencies in conducting coordinated examinations in accordance with Section 1, Part I of the Handbook. To the extent that an insurance group is organized into subgroups for examination purposes, the review, assessment and utilization of various aspects of the insurance group's ORSA Summary Report may require delegation of responsibilities to an Exam Facilitator. However, in all cases, examination teams should seek to avoid duplication and utilize existing work in reviewing, assessing and utilizing the ORSA Summary Report to conduct

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examinations of entities that are part of an insurance group. Throughout the remainder of this document, the term "Lead State" is used before the term "examiner" or "regulator" with the understanding that in most situations, the ORSA Summary Report will be prepared on a group basis, and, therefore, primarily reviewed by the Lead State. However, this does not remove the requirement for the domestic state to perform these responsibilities in the event of a single-entity ORSA Summary Report.

For additional guidance for sharing the ORSA Summary Report and/or the Lead State's analysis of the ORSA Summary Report with other regulators and/or other third parties, refer to the ORSA Information Sharing Best Practices found on the ORSA Implementation (E) Subgroup webpage.

As stated in the *NAIC ORSA Guidance Manual* (Guidance Manual), the ORSA has two primary goals:

1. To foster an effective level of ERM for all insurers, through which each insurer identifies, assesses, monitors, prioritizes and reports on its material and relevant risks identified by the insurer using techniques appropriate to the nature, scale and complexity of the insurer's risks, in a manner adequate to support risk and capital decisions.

2. To provide a group-level perspective on risk and capital, as a supplement to the existing legal entity view.

The Guidance Manual states that regulators should obtain a high-level understanding of the insurer's ORSA framework, and discusses how the ORSA Summary Report may assist in determining the scope, depth and minimum timing of risk-focused analysis and examination procedures.

These determinations can be documented as part of each insurer's ongoing supervisory plan. However, the Guidance Manual also states that each insurer's ORSA will be unique, reflecting the insurer's business model, strategic planning and overall approach to ERM. As regulators review ORSA Summary Reports, they should understand that the level of sophistication for each group's ERM program will vary depending upon size, scope and nature of business operations. Understandably, less complex organizations may not require intricate processes to possess a sound ERM program. Therefore, regulators should use caution before using the results of an ORSA review to modify ongoing supervisory plans, as a variety of practices may be appropriate depending upon the nature, scale and complexity of each insurer.

Collectively, the goals above are the basis upon which the guidance is established. However, the ORSA Summary Report will not serve this function or have this direct impact until the Lead State becomes fairly familiar with and comfortable with evaluating each insurer's report and its processes. This could take more than a couple of years to occur in practice since the Lead State would likely need to review at least one or two ORSA Summary Reports to fully understand certain aspects of the processes used to develop the report.

B. General Summary of Guidance for Each Section

This section is designed to assist the examiner through general guidance regarding how each section of the ORSA Summary Report is expected to be reviewed and assessed during a financial examination. This guidance is expected to evolve over the years, with the first couple of years focused on developing a general understanding of ORSA and ERM. Each of the sections of the ORSA Summary Report requires distinct consideration to be adequately understood and assessed. However, each of the sections can supplement the understanding and assessment of the other sections. For example, Section III provides an insurer the opportunity to demonstrate the robustness of its process by including a detailed description of the reasonably foreseeable and relevant material risks it faces and their potential impact to the insurer. This can allow the Lead State regulator to gain a better understanding and increased appreciation for the insurer's processes to identify and prioritize reasonably foreseeable and relevant material risks described in Section I. Alternately, the Lead State regulator may assess stresses applied to individual risks in Section II as appropriate, but may not feel stresses are appropriately aggregated to determine an adequate group capital assessment in Section III. Therefore, the review and assessment of each section requires a full understanding of each of the other sections, and the Lead State regulator should exercise caution in the allocation of review responsibilities in this area.

Further, regulators do not believe there is a standard set of stress conditions each insurer should test. The Lead State examiner should never specify the stresses to be performed, nor what should be included in the insurer's ORSA Summary

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Report, as this would eliminate the "Own" aspect of the ORSA and defeat its purpose, which is to permit the Lead State regulator to better understand the risk from the perspective of the insurer. This is not to suggest that the Lead State examiner should not consider asking questions about the extent to which the insurer considers particular risks, as these questions may provide the insurer an opportunity to discuss the robustness of its processes and considerations, either in specifically identified stresses or the inclusion of similar risks within a stochastic economic capital model for a particular risk.

Section I

The guidance in Section I is designed to assist the Lead State examiner in reaching an assessment of the risk management framework of the insurer. The Lead State examiner's assessment should utilize existing assessments of the insurer's risk management framework performed by the Lead State financial analyst through a review of the ORSA Summary Report, but should supplement the Lead State analyst's assessment with additional on-site verification and testing to reach a final conclusion.

The Section I procedures are focused on determining the insurer's maturity level in regards to its overall risk management framework. The maturity level may be assessed through several ways, one of which is the incorporation of concepts developed within the Risk and Insurance Management Society's (RIMS) Risk Maturity Model (RMM). While insurers or insurance groups may utilize various frameworks in developing, implementing and reporting on their ORSA processes (e.g. COSO Integrated Framework, ISO 31000, IAIS ICP 16, other regulatory frameworks, etc.), elements of the RMM have been incorporated into this guidance to provide a framework for use in reviewing and assessing ERM/ORSA practices. However, as various frameworks may be utilized to support effective ERM/ORSA practices, Lead State regulators should be mindful of differences in frameworks and allow flexibility in assessing maturity levels. The RMM, which is only one of several processes that may be used to determine maturity levels, provides a scale of six maturity levels upon which an insurer can be assessed. The six maturity levels can generally be defined as follows:

- Level 5: Risk management is embedded in strategic planning, capital allocation and other business processes, and is used in daily decision-making. Risk limits and early warning systems are in place to identify breaches and require corrective action from the board of directors or committee thereof (hereafter referred to as "board") and management.

- Level 4: Risk management activities are coordinated across business areas, and tools and processes are actively utilized. Enterprise-wide risk identification, monitoring, measurement and reporting are in place.

- Level 3: The insurer has risk management processes in place designed and operated in a timely, consistent and sustained way. The insurer takes action to address issues related to high priority risks.

- Level 2: The insurer has implemented risk management processes, but the processes may not be operating consistently and effectively. Certain risks are defined and managed in silos, rather than consistently throughout the organization.

- Level 1: The insurer has not developed or documented standardized risk management processes and is relying on the individual efforts of staff to identify, monitor and manage risks.

- Level 0: The insurer has not recognized a need for risk management, and risks are not directly identified, monitored or managed.

The [illegible]developed for use in this Handbook integrates the concepts of the RMM with the general principles and elements outlined in Section I of the Guidance Manual to assist Lead State regulators in reaching an overall assessment of the maturity of an insurer's risk management framework. The design of ERM/ORSA practices should appropriately reflect the nature, scale and complexity of the company. Lead State regulators should understand the level of maturity that is appropriate for the company based on its unique characteristics. Attainment of Level 5 maturity for ERM/ORSA practices is not appropriate, nor should be expected, for all companies or for all components of the framework.

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Section II

The guidance for use in reviewing Section II is primarily focused on assisting the Lead State examiner in gaining an understanding of management's assessment of its reasonably foreseeable and relevant material risks. In addition, the guidance assists the Lead State examiner in understanding the potential impact of reasonably foreseeable and relevant material risks by considering the stress scenarios and stress testing presented by the insurer. Finally, information in Section II can inform or support the assessment of key principles reached during a review of Section I.

In order for the Lead State examiner to understand and utilize the information on reasonably foreseeable and relevant material risks provided in Section II, the Lead State examiner must obtain a minimum level of confidence regarding the reasonability of the information presented. Much of the Section II guidance has been developed around the nine branded risk classifications outlined in Exhibit L of this Handbook, which are used as a common language in the risk-focused surveillance process. The primary reason for this approach is that insurers may utilize similar risk classifications in their ORSA Summary Reports. However, Lead State regulators should not restrict their focus to only the nine branded risk classifications as such an approach may not encourage independent judgment in understanding the risk profile of the insurer. Therefore, the use of the nine branded risk classifications provides a framework to organize the Lead State's summary, but should not discourage regulators from documenting other risks or excluding branded risk categories that aren't relevant. From this standpoint, Section II will also provide regulators with information to better understand current insurance market risks, changes in those risks as well as macroeconomic changes, and the impact they have on insurers' risk identification and risk management processes.

As part of evaluating the information presented on reasonably foreseeable and relevant material risks, the Lead State examiner may document how the insurer determines the appropriateness of its stress scenarios identified and stress testing performed by the insurer. However, regulators do not believe there is a standard set of stress conditions each insurer should test. Consistent with the language in the Guidance Manual, the Lead State examiner should not specify the stresses to be performed, nor what should be included in the company's ORSA Summary Report. Therefore, guidance has been provided to assist the Lead State examiner in considering the reasonableness of the assumptions and methodologies used in conducting stress scenarios/testing and to facilitate discussion with the insurer.

Section III

The guidance for reviewing Section III of the ORSA Summary Report is intended to assist the Lead State examiner in understanding and assessing the estimated amount of capital the insurer determines is reasonable to sustain its current business model. This determination typically utilizes and/or aggregates the outputs of Section II (i.e., stress testing) to calculate the amount of capital required to support ongoing business operations for a wide range of potential outcomes. Therefore, much of the guidance in this section relates back to how the insurer determines the reasonableness of the assumptions and methodologies utilized to calculate and allocate capital to the reasonably foreseeable and relevant material risks it faces. Often, this calculation may be wholly or partially based on internal models developed by the insurer for this purpose. Therefore, the guidance also directs the Lead State examiner to consider and evaluate the insurer's processes to validate the suitability, reasonability and reliability of its internal models.

C. Review of Section I - Description of the Insurer's Risk Management Framework

The Guidance Manual requires the insurer to discuss five key principles of an effective risk management framework in Section I of the ORSA Summary Report. Therefore, the Lead State examiner is required to review and assess the insurer's risk management framework by considering and evaluating each of the key principles. Upon receipt of the ORSA Summary Report, the Lead State financial analyst should perform an initial, high-level assessment of each of the key principles. During an on-site examination, the Lead State examiner is expected to supplement this initial assessment with additional procedures to verify the reported information and test the operating effectiveness of the insurer's risk management processes and practices. Upon conclusion of these procedures, the Lead State examiner should reach his or her own assessment regarding each of the five principles. This should be utilized to adjust the scope of the risk-focused examination and communicated back to the Lead State financial analyst for ongoing monitoring and adjustment of the supervisory plan.

Guidance is provided to assist the Lead State examiner in developing review procedures and to give examples of attributes that may indicate the insurer is more or less mature in its handling of the individual key risk management principles.

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These attributes are meant to assist the Lead State examiner in reaching an assessment of the insurer's maturity level for each key principle.

Key Principles

1. Risk Culture and Governance
2. Risk Identification and Prioritization
3. Risk Appetite, Tolerances and Limits
4. Risk Management and Controls
5. Risk Reporting and Communication

Considerations When Reviewing Key Principles

When reviewing processes described in the ORSA Summary Report, the Lead State examiner should consider the extent to which the above principles are integrated into the organization. To do so, the Lead State examiner may need to review processes and practices beyond those documented within the ORSA Summary Report. In addition, the Lead State examiner may need to review and consider changes made to risk management processes since the filing of the last ORSA Summary Report. In so doing, the Lead State examiner may consider information beyond what is included in the ORSA Summary Report to reach an assessment of the insurer's maturity level for each key principle.

In reviewing these key principles, examples of various attributes/traits associated with various maturity levels for each key principle are provided. However, these attributes only demonstrate common currently known practices associated with each of the various maturity levels, and practices of individual insurers may vary significantly from the examples provided. It is possible that the insurer has mature practices in place even if those practices differ from the example attributes provided. Therefore, the Lead State examiner should exercise professional judgment in determining the appropriate maturity level to select when assessing each of the key risk management principles.

1. **Risk Culture and Governance**

It's important to note some organizations view risk culture and governance as the cornerstone to managing risk. The Guidance Manual defines this item to include a structure that clearly defines and articulates roles, responsibilities and accountabilities, as well as a risk culture that supports accountability in risk-based decision making. Therefore, the objective is to have a structure in place within the organization that manages reasonably foreseeable and relevant material risk in a way that is continuously improved.

Level 5

Risk culture is analyzed and reported as a systematic view of evaluating risk. Executive sponsorship is strong, and the tone from the top has sewn an ERM framework into the corporate culture. Management establishes the framework and the risk culture, and the board reviews the risk appetite statement in collaboration with the chief executive officer (CEO), chief risk officer (CRO) where applicable and chief financial officer (CFO). Those officers translate the expectations into targets through various practices embedded throughout the organization. Risk management is embedded in each material business function. Internal audit, information technology, compliance, controls and risk management processes are integrated, and coordinate and report risk issues. Material business functions use risk-based best practices. The risk management life cycle for business process areas are routinely evaluated and improved (when necessary).

Level 4

The insurer's ERM processes are self-governed with shared ethics and trust. Management is held accountable. Risk management issues are understood and risk plans are conducted in material business process areas. The board, CEO, CRO (if applicable) and CFO expect a risk management plan to include a qualitative risk assessment for reasonably foreseeable and relevant material risks with reporting to management or the board on priorities, as appropriate. Relevant areas use the ERM framework to enhance their functions, communicating on risk issues as appropriate. Process owners incorporate managing their risks and opportunities within regular planning cycles. The insurer creates and evaluates scenarios consistent with its planning horizon and product timelines, and follow-up activities occur accordingly.

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Level 3
ERM risk plans are understood by management. Senior management expects that a risk management plan captures reasonably foreseeable and relevant material risks in a qualitative manner. Most areas use the ERM framework and report on risk issues. Process owners take responsibility for managing their risks and opportunities. Risk management creates and evaluates scenarios consistent with the business planning horizon.

Level 2
Risk culture is enforced by policies interpreted primarily as compliance in nature. An executive champions ERM management to develop an ERM framework. One area has used the ERM framework, as shown by the department head and documented team activities. Business processes are identified, and ownership is defined. Risk management is used to consider risks in line with the insurer's business planning horizon.

Level 1
Corporate culture has little risk management accountability. Risk management is not interpreted consistently. Policies and activities are improvised. Programs for compliance, internal audit, process improvement and IT operate independently and have no common framework, causing overlapping risk assessment activities and inconsistencies. Controls are based on departments and finances. Business processes and process owners are not well defined or communicated. Risk management focuses on past events. Qualitative risk assessments are unused or informal. Risk management is considered a quantitative analysis exercise.

Level 0
There is no recognized need for an ERM process and no formal responsibility for ERM. Internal audit, risk management, compliance and financial activities might exist, but they aren't integrated. Business processes and risk ownership are not well defined.

2. **Risk Identification and Prioritization**

The Guidance Manual defines this as key to the organization, and responsibility for this activity should be clear. The risk management function is responsible for ensuring these processes are appropriate and functioning properly. Therefore, an approach for risk identification and prioritization may be to have a process in place that identifies risk and prioritizes such risks in a way that potential reasonably foreseeable and relevant material risks are addressed in the framework.

Level 5
Information from internal and external sources on reasonably foreseeable and relevant material risks, including relevant business units and functions, is systematically gathered and maintained. A routine, timely reporting structure directs risks and opportunities to senior management. The ERM framework promotes frontline employees' participation and documents risk issues' or opportunities' significance. Process owners periodically review and recommend risk indicators that best measure their areas' risks. The results of internal adverse event planning are considered a strategic opportunity.

Level 4
Process owners manage an evolving list of reasonably foreseeable and relevant material risks locally to create context for risk assessment activities as a foundation of the ERM framework. Risk indicators deemed critical to their areas are regularly reviewed in collaboration with the ERM team. Measures ensure downside and upside outcomes of risks and opportunities are managed. Standardized evaluation criteria of impact, likelihood and controls' effectiveness are used to prioritize risk for follow-up activity. Risk mitigation is integrated with assessments to monitor effective use.

Level 3
An ERM team manages an evolving list of reasonably foreseeable and relevant material risks, creating context for risk assessment as a foundation of the ERM framework. Risk indicator lists are collected by most process owners. Upside and downside outcomes of risk are understood and managed. Standardized evaluation criteria of impact, likelihood and controls' effectiveness are used, prioritizing risk for follow-ups. Enterprise-level information on risks and opportunities are shared. Risk mitigation is integrated with assessments to monitor effective use.

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Level 2
Formal lists of reasonably foreseeable and relevant material risks exist for each relevant business unit or function, and discussions of risk are part of the ERM process. Corporate risk indicators are collected centrally, based on past events. Relevant business units or functions might maintain their own informal risk checklists that affect their areas, leading to potential inconsistency, inapplicability and lack of sharing or under-reporting.

Level 1
Risk is owned by specialists, centrally or within a business unit or function. Risk information provided to risk managers is probably incomplete, dated or circumstantial, so there is a high risk of misinformed decisions, with potentially severe consequences. Further mitigation, supposedly completed, is probably inadequate or invalid.

Level 0
There might be a belief that reasonably foreseeable and relevant material risks are known, although there is probably little documentation.

3. **Risk Appetite, Tolerances and Limits**

The Guidance Manual states that a formal risk appetite statement, and associated risk tolerances and limits, are foundational elements of a risk management framework for an insurer. Understanding of the risk appetite statement ensures alignment with the risk strategy set by senior management and reviewed and evaluated by the board. Not included in the Guidance Manual, but widely considered, is that risk appetite statements should be easy to communicate, understood and closely tied to the organization's strategy. After the overall risk appetite for the organization is determined, the underlying risk tolerances and limits can be selected and applied to business units and risk areas as the company deems appropriate. The company may apply appropriate quantitative limits and qualitative statements to help establish boundaries and expectations for risks that are hard to measure. These boundaries may be expressed in terms of earnings, capital or other metrics, such as growth and volatility. The risk tolerances/limits provide direction outlining the insurer's tolerance for taking on certain risks, which may be established and communicated in the form of the maximum amount of such risk the entity is willing to take. However, in many cases, these will be coupled with more specific and detailed limits or guidelines the insurer uses. Due to the varying level of detail and specificity different organizations incorporate into their risk appetites, tolerances and limits, lead State regulators should consider these elements collectively to reach an overall assessment in this area and should seek to understand the insurer's approach through follow-up discussions and dialogue.

Level 5
A risk appetite statement has been developed to establish clear boundaries and expectations for the organization to follow. A process for delegating authority to accept risk levels in accordance with the risk appetite statements is communicated throughout the organization. The management team and risk management committee, if applicable, may define tolerance levels and limits on a quantitative and/or qualitative basis for relevant business units and functions in accordance with the defined risk appetite. As part of its risk management framework, the company may compare and report actual assessed risk versus risk tolerances/limits. Management prioritizes resource allocation based on the gap between risk appetite and assessed risk and opportunity. The established risk appetite is examined periodically.

Level 4
Risk appetite is considered throughout the ERM framework. Resource allocation decisions consider the evaluation criteria of business areas. The organization forecasts planned mitigation's potential effects versus risk tolerance as part of the ERM framework. The insurer's risk appetite is updated as appropriate and risk tolerances are evaluated from various perspectives as appropriate. Risk is managed by process owners. Risk tolerance is evaluated as a decision to increase performance and measure results. Risk-reward tradeoffs within the business are understood and guide actions.

Level 3
Risk assumptions within management decisions are clearly communicated. There's a structure for evaluating risk on an enterprise-wide basis and for gauging risk tolerance. Risks and opportunities are routinely identified, evaluated and executed in alignment with risk tolerances. The ERM framework quantifies gaps between actual

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and target tolerances. The insurer's risk appetite is periodically reviewed and updated as deemed appropriate by the company, and risk tolerances are evaluated from various perspectives as appropriate.

Level 2
Risk assumptions are only implied within management decisions and are not understood outside senior leadership with direct responsibility. There is no ERM framework for resource allocation. Defining different views of business units or functions from a risk perspective cannot be easily created and compared.

Level 1
Risk management might lack a portfolio view of risk. Risk management might be viewed as risk avoidance and meeting compliance requirements or transferring risk through insurance. Risk management might be a quantitative approach focused on the analysis of high-volume and mission-critical areas.

Level 0
The need for formalizing risk tolerance and appetite is not understood.

4. **Risk Management and Controls**

The Guidance Manual stresses managing risk is an ongoing ERM activity, operating at many levels within the organization. This principle is discussed within the governance section above from the standpoint that a key aspect of managing and controlling the reasonably foreseeable and relevant material risks of the organization is the governance process put in place. For many companies, the day-to-day governance starts with the relevant business units. Those units put mechanisms in place to identify, quantify and monitor risks, which are reported up to the next level based upon the risk reporting and risk limits put in place. In addition, controls are also put in place on the back end, by either the internal audit team or an independent consultant, which are designed to ensure compliance and a continual enhancement approach. Therefore, one approach may be to put controls in place to ensure the organization is abiding by its limits.

Level 5
ERM, as a management tool, is embedded in material business processes and strategies. Roles and responsibilities are process-driven, with teams collaborating across material central and field positions. Risk and performance assumptions within qualitative assessments are routinely revisited and updated. The organization uses an ERM process of sequential steps that strive to improve decision-making and performance. A collaborative, enterprise-wide approach is in place to establish a risk management committee staffed by qualified management. Accountability for risk management is woven into all material processes, support functions, business lines and geographies as a way to achieve goals. To evaluate and review the effectiveness of ERM efforts and related controls, the organization has implemented a "Three Lines of Defense" model or similar system of checks and balances that is effective and integrated into the insurer's material business processes. The first line of defense may consist of business unit owners and other front-line employees applying internal controls and risk responses in their areas of responsibility. The second line of defense may consist of risk management, compliance and legal staff providing oversight to the first line of defense and establishing framework requirements to ensure reasonably foreseeable and relevant material risks are actively and appropriately managed. The third line of defense may consist of auditors performing independent reviews of the efforts of the first two lines of defense to report back independently to senior management or the board, as appropriate.

Level 4
Risk management is clearly defined and enforced at relevant levels. A risk management framework articulates management responsibility for risk management, according to established risk management processes. Management develops and reviews risk plans through involvement of relevant stakeholders. The ERM framework is coordinated with managers' active participation. Opportunities associated with reasonably foreseeable and relevant material risks are part of the risk plans' expected outcome. Authentication, audit trail, integrity and accessibility promote roll-up information and information sharing. Periodic reports measure ERM progress on all reasonably foreseeable and relevant material risks for stakeholders, including senior management or the board, as appropriate. The organization has implemented a "Three Lines of Defense" model to review and assess its control effectiveness, but those processes may not yet be fully integrated or optimized.

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Level 3
The ERM framework supports material business units' and functions' needs. ERM is a process of steps to identify, assess, evaluate, mitigate and monitor reasonably foreseeable and relevant material risks. ERM frameworks include the management of opportunities. Senior management actively reviews risk plans. The ERM process is collaborative and directs important issues to senior management. The "Three Lines of Defense" are generally in place but are not yet performing at an effective level.

Level 2
Management recognizes a need for an ERM framework. Agreement exists on a framework, which describes roles and responsibilities. Evaluation criteria are accepted. Risk mitigation activities are sometimes identified but not often executed. Qualitative assessment methods are used first in all material risk areas and inform what needs deeper quantitative methods, analysis, tools and models. The "Three Lines of Defense" are not yet fully established, although some efforts have been made to put these processes in place.

Level 1
Management is reactive, and ERM might not yet be seen as a process and management tool. Few processes and controls are standardized and are instead improvised. There are no standard risk assessment criteria. Risk management is involved in business initiatives only in later stages or contrarily. Risk roles and responsibilities are informal. Risk assessment is improvised. Standard collection and assessment processes are not identified.

Level 0
There is little recognition of the ERM framework's importance or controls in place to ensure its effectiveness.

5. **Risk Reporting and Communication**

The Guidance Manual indicates risk reporting and communication provides key constituents with transparency into the risk-management processes and facilitates active, informal decisions on risk-taking and management. The transparency is generally available because of reporting that can be made available to management, the board or compliance departments, as appropriate. However, most important is how risk reports are being utilized to identify and manage reasonably foreseeable and relevant material risks at either the group, business unit or other level within the organization where decisions are made. Therefore, one approach may be to have reporting in place that allows decisions to be made throughout the organization by appropriately authorized people, with ultimate ownership by senior management or the board, as appropriate.

Level 5
The ERM framework is an important element in strategy and planning. Evaluation and measurement of performance improvement is part of the risk culture. Measures for risk management include process and efficiency improvement. The organization measures the effectiveness of managing uncertainties and seizing risky opportunities. Deviations from plans or expectations are also measured against goals. A clear, concise and effective approach to monitor progress toward strategic goals is communicated regularly with relevant business units or functional areas. Individual, management, departmental, divisional and corporate strategic goals are linked with standard measurements. The results of key measurements and indicators are reviewed and discussed by senior management and the board, as appropriate, on a regular basis and as frequently as necessary to address breaches in risk tolerances or limits in a timely manner.

Level 4
The ERM framework is an integrated part of strategy and planning. Risks are considered as part of strategic planning. Risk management is a formal part of strategic goal setting and achievement. Investment decisions for resource allocation examine the criteria for evaluating opportunity impact, timing and assurance. The organization forecasts planned mitigation's potential effect on performance impact, timing and assurance prior to use. Employees at all relevant levels use a risk-based approach to achieve strategic goals. The results of key measurements and indicators are shared with senior management and the board, as appropriate, on a regular basis.

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Level 3
The ERM framework contributes to strategy and planning. Strategic goals have performance measures. While compliance might trigger reviews, other factors are integrated, including process improvement and efficiency. The organization indexes opportunities qualitatively and quantitatively, with consistent criteria. Employees understand how a risk-based approach helps them achieve goals. Accountability toward goals and risk's implications are understood and are articulated in ways frontline personnel understand. The results of key measurements and indicators are shared with senior management and the board, as appropriate.

Level 2
The ERM framework is separate from strategy and planning. A need for an effective process to collect information on opportunities and provide strategic direction is recognized. Motivation for management to adopt a risk-based approach is lacking.

Level 1
Not all strategic goals have measures. Strategic goals aren't articulated in terms the frontline management understands. Compliance focuses on policy and is geared toward satisfying external oversight bodies. Process improvements are separate from compliance activities. Decisions to act on risks might not be systematically tracked and monitored. Monitoring is done, and metrics are chosen individually. Monitoring is reactive.

Level 0
No formal framework of indicators and measures for reporting on achievement of strategic goals exists.

Examination Procedures for Section I

The following table provides example test procedures that may be performed by the Lead State examiner to verify information on risk management processes included in the ORSA Summary Report or to test the operating effectiveness of such practices. Several of these procedures may be performed in conjunction with other risk-focused examination processes, and Lead State examiners should attempt to gain efficiencies by coordinating testing and review efforts wherever possible. Lead State examiners should use professional judgment in selecting or tailoring procedures to assist in the assessment of each of the five risk management principles for the insurer. In addition, the Lead State examiner should incorporate any specific verification or testing recommendations made by the Lead State financial analyst into the planned examination procedures for Section I and consider the extent to which additional procedures should be utilized to test the changes that have been made to the insurer's ERM framework since the last on-site examination.

Principle	Possible Test Procedures
Risk Culture and Governance	Obtain and review management, board or committee minutes/packets for the director group responsible for ERM oversight and evaluate the level of oversight provided. • Obtain and review formal ERM training materials provided by the insurer to relevant employees and directors. • Interview management or board member(s) with responsibilities for risk management oversight to determine level of knowledge and involvement of management or directors in risk management processes. • Interview insurer executives to get a feel for the "tone at the top" of the organization and the level of consistency in applying risk management processes across departments. • Obtain and review information on the insurer's compensation plans to determine that risk management decision-making is not undermined by compensation structure. • Obtain and review job descriptions or performance review criteria for select management positions to determine whether risk management elements are incorporated.

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Principle	Possible Test Procedures
Risk Identification and Prioritization	• Obtain a current copy of the organization's risk listing/universe. • Determine whether appropriate external sources have been used to assist in risk identification (e.g. rating agency information, competitor 10K filings, etc.) where applicable. • Verify that the organization's risk listing/universe is updated/reviewed on a regular basis by requesting copies at various dates. • Assess the insurer's process and scale by which it prioritizes the key risks identified. • Review the approach for and results of the insurer's likelihood, severity and speed of onset risk assessments, if applicable. • Interview select process owners/business unit leaders to verify their role in risk identification and prioritization. • Interview risk management staff to understand and evaluate how risks are identified and aggregated across the organization.
Risk Appetite, Tolerances and Limits	• Review the management committee's or board's supporting materials to verify that the organization's risk appetite is reviewed as appropriate. • Review and evaluate how risk appetite, tolerances and limits are set for the insurer. • Determine whether the insurer considers legal entity regulations and capital requirements in setting the overall risk appetite (if applicable). • Review and evaluate steps taken to address breaches in risk limits on a sample basis (if applicable). • Verify, as applicable, whether reasonably forseeable material and relevant risks are assigned risk owners to monitor risks and oversee mitigation plans. • Interview select risk owners to get an understanding of how risk limits are set and updated. • Verify that checks and balances (i.e., supervisory review) are in place to ensure that risk limits are set in accordance with the organization's overall risk appetite.
Risk Management and Controls	• Obtain minutes of internal risk management committee (or equivalent management group) meetings to review frequency and extent of oversight activities. • Obtain a listing of internal audit reports to determine whether risk management processes are subject to periodic review. • Identify and test the operating effectiveness of preventive controls in select areas to determine how risk limits are enforced. • Review and evaluate how specific controls are mapped to legal entities (as appropriate if mapping is relevant to understanding of control).
Risk Reporting and Communication	• Obtain a current copy of the organization's risk dashboard (or equivalent report) to verify that tracking for reasonably foreseeable material and relevant risk areas exists. • Verify the frequency with which risk information is accumulated and reported by selecting a sample of historical risk dashboards (or equivalent reports) to review. • Test the reasonableness of information included on the risk dashboard (or equivalent report) on a sample basis. • Determine whether risk reporting information is evaluated by the board and used by senior management for strategy and planning purposes. • Review and evaluate the timeliness with which breaches in risk limits are reported and communicated to the appropriate authority.

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Documentation for Section I

The Lead State examiner should prepare documentation summarizing the results of the risk management framework assessment by addressing each of the five principles set forth in the Guidance Manual using the template at the end of this section. Each assessment should first provide a summary of the Lead State analyst's initial assessment, followed by a summary of the results of exam procedures, leading to a final exam assessment for each principle. The summary of exam results should provide rationale for any deviation from the Lead State analyst's initial assessment of the principle.

D. Review of Section II - Insurer's Assessment of Risk Exposure

Section II of the ORSA Summary Report is required to provide a high-level summary of the insurer's quantitative and/or qualitative assessments of its exposure to reasonably foreseeable and relevant material risks. There may be a great deal of variation in how this information is displayed from one insurer to the next, but in most cases, insurers tend to organize this information around the reasonably foreseeable and relevant material risks of the insurer. The Guidance Manual does give possible examples of relevant material risk categories (credit, market, liquidity, underwriting, and operational risks). In reviewing the information provided in this section of the ORSA, Lead State regulators may need to pay particular attention to risks and exposures that may be emerging or significantly increasing over time.

Lead State examiners may find the information regarding reasonably foreseeable and relevant material risk exposures the most beneficial aspect of the ORSA Summary Report, as this information may be useful in identifying risks and controls for use in the remaining phases of a risk-focused examination. This may be attributed to the fact that Section II provides risk information on the insurance group that may be grouped in categories similar to the NAIC's nine branded risk classifications (see Exhibit L). However, the grouping of risk information in the report is entirely up to the insurer, and the Lead State examiner should not expect each of the nine branded risk classifications to be directly addressed within Section II.

Stress Testing

In addition to providing background information on reasonably foreseeable and relevant material risks the insurer is facing, Section II anticipates the risk exposures to be analyzed under both normal and stressed environments. Therefore, as part of evaluating the information presented, the Lead State examiner is expected to consider the stress scenarios identified and assessment techniques performed by the insurer. In so doing, the Lead State examiner should note the assumptions and methodologies used by the insurer in conducting stress scenarios/testing. The Lead State examiner should obtain information from the Lead State analyst to determine the extent to which the state has already been provided information on the assumptions and methodologies.

The Lead State examiner should consider the assessment techniques the insurer has utilized to evaluate the impact that reasonably foreseeable and relevant material risks could have on its ongoing operations. In reviewing the insurer's efforts in this area, the Lead State examiner's focus would be on considering if additional information and support for the stress testing of individual risks or groups of risks are available in order to test the effectiveness of such processes. In reviewing the insurer's assessment techniques for each of the nine branded risk classifications (if applicable) and other relevant risks, the Lead State examiner should consider each of the following elements:

- Was each of the insurer's significant solvency risks facing the insurer identified and subjected to assessment techniques?
- If scenarios were utilized to evaluate/stress the impact of such risks, were they appropriately described and justified?
- Were techniques utilized to assess reasonably forseeable material and relevant risks in accordance with insurer standards and industry best practices?
  - Did the time horizon or duration of the risks identified have an impact on the nature and extent of the assessment techniques selected?
- Did the results of the assessment techniques indicate that the insurer had appropriately mitigated the impact that the risk might have on the insurer?
- Do the assessment techniques utilized address issues from both a capital and liquidity perspective?

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Documentation for Section II

Upon the conclusion of the Lead State examiner's review and testing of the information provided in Section II and related processes, documentation should be prepared to discuss whether the insurer included an appropriate discussion of reasonably foreseeable and relevant material risks. The nine branded risk classifications may be discussed within this summary, as well as any additional risk categories that the Lead State examiner deems relevant. In addition, the Lead State examiner should provide an assessment of the corresponding stress assumptions and test results presented for each of the risk categories discussed, keeping in mind that a company is not required to solely focus on the nine branded risk classifications.

E. Review of Section III - Group Assessment of Risk Capital

Section III of the ORSA is unique in that it is required to be completed at the insurance group level, as opposed to the other sections, which may be completed at a legal entity level. However, in many cases, insurers will choose to also complete Sections I and II at the group level. The requirement to complete Section III at the group level is important because it provides the means for Lead State insurance regulators to assess the reasonableness of capital of the entire insurance group based upon its existing business plan. The focus of financial analysis in reviewing Section III will be to understand the insurer's assessment of the reasonableness of capital of the entire group to withstand potential losses and detrimental events, as well as the prospective outlook of the insurer's solvency position. The focus of the Lead State examiner in reviewing Section III should be on understanding the process the insurer used to accumulate and present the information provided. To perform this review, the Lead State examiner may need to request additional detail supporting the group capital calculations that the insurer performed.

Insurance groups will use different means to measure estimated risk (required) capital, and they will use different accounting and valuation frameworks. The Lead State examiner, in conjunction with the Lead State analyst, may need to request management to discuss their overall approach to both the accounting and valuation frameworks, as well as the reasons and details for each. A different accounting basis can result in a significant difference in perceived risk exposures and capital needs.

The ORSA Summary Report should summarize the insurer's process for model validation, including factors considered and model calibration. Because the risk profile of each insurer is unique, there is no standard set of stress conditions that each insurer should run. However, the Lead State regulator should be prepared to dialogue with management about the selected stress scenarios if there is concern with the rigor of the scenario. In discussions with management, the Lead State regulator should gain an understanding of the modeling methods used (e.g., stochastic vs. deterministic) and be prepared to dialogue about and understand the material assumptions that affected the model output, such as prospective views on risks. The aforementioned dialogue may occur during either the financial analysis process and/or the financial examination process.

In focusing on the insurer's process to calculate and assess its group risk capital, the Lead State examiner will need to consider the source of the group's internal capital assessment. Some insurers may develop a group capital assessment based upon external models developed by third-party vendors, regulators or rating agencies, while other insurers may also consider and assess the results of an internal capital model. While the insurer is free to select whichever approach or combination of approaches is appropriate to meet its needs, the Lead State examiner should consider whether the approach selected is consistent with the nature, size and extent of risks that the group faces. In addition, the Lead State examiner should evaluate the work that the insurer performed to validate the approach and model utilized.

Internal Capital Models

The Guidance Manual states the analysis of an insurer's group assessment of risk capital requirements and associated capital adequacy description should be accompanied by a description of the approach used in conducting the analysis. This should include key methodologies, assumptions and considerations used in quantifying available capital and risk capital. Examples of information to be provided in Section III describing an insurer's processes in this area are provided in the Guidance Manual, and Lead State examiners should become familiar with these elements in order to assess an insurer's processes in this area.

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In reviewing an insurer's use of internal models, the Lead State examiner should gain an understanding of the work that the insurer performed to validate its own models, whether completed by internal audit, a third-party consultant or some other party. The importance of reviewing the insurer's self-validation process is not only to gain comfort on the information provided in Section III of the report, but also due to the fact that the insurer may be making business decisions based on the results of its modeling. This is an important step because the Lead State examiner is encouraged to look to the insurer's own process by which it assesses the accuracy and robustness of its models, as well as how it governs model changes and parameter or assumption setting, and limits Lead State examiner validation of reports to more targeted instances where conditions warrant additional analysis.

Depending upon the strength of the insurer's internal model validation processes, Lead State examiners may need to perform some level of independent testing to review and evaluate the controls over internal model(s) utilized by the insurer for its group economic capital calculation. This is largely due to the challenges inherent in developing, implementing and maintaining an effective internal capital model. In instances where independent testing is deemed necessary, this testing may consist of procedures to evaluate the appropriateness of assumptions and methodologies used in stochastic/deterministic modeling scenarios for individual risks or in estimating the amount of diversification benefit realized. In so doing, the Lead State examiner may need to select a sample of individual risks for review and consideration, and involve an actuary to assist in the evaluation. When involving an actuary, the primary focus of this review would be on evaluating the reasonableness of the inputs and outputs of the models. An actuary may be able to provide input on the reasonableness of the inputs, while the outputs may be more easily tested by performing a walkthrough in which the inputs are modified, and the Lead State examiner or actuary evaluates and discusses with the insurer the impact that the change has on the outputs. There is no one set of assumptions or methodologies that fits every company. The Lead State examiner may consider asking questions about the modeling approach that the company uses, as such questions may provide the company an opportunity to elaborate on information provided in the ORSA Summary Report and further the Lead State examiner's understanding.

External Capital Models

For some insurers, the group capital assessment may be based upon external capital models. If an insurer presents its standing in relation to external capital models, the insurer may provide information showing its potential standing after considering the impact of stresses. This information may be beneficial as it can demonstrate what types of events an insurer could withstand before potentially losing its rating or violating regulatory capital requirements. While some of this information may be presented in Section II of the report, the impact of stresses on external capital models, while not required, should be considered in an assessment of Section III. There are several ways this can be demonstrated, including the rigor the insurer applies to its stress scenarios.

If an insurer bases its group capital assessment largely on third-party vendor tools, rating agency capital calculations or regulatory capital requirements, the Lead State examiner should consider the appropriateness of such reliance based upon the nature, scale and complexity of the insurer's reasonably foreseeable and relevant material risks. In addition, the Lead State examiner should consider whether the insurer has applied reasonable stress scenarios to its available capital to determine its prospective standing in relation to external capital models under a wide range of different scenarios.

Prospective Solvency Assessment

The Guidance Manual requires the insurer to consider the prospective solvency of the group. Many companies will include information developed as part of their strategic planning, including pro forma financial information displaying possible outcomes as well as projected capital adequacy in those future periods based on the insurer's defined capital adequacy standards. However, the Lead State examiner should review the information provided to understand the impact such an exercise has on the ongoing business plans of the group. For example, to the extent such an exercise suggests that at the insurer's particular capital adequacy under expected outcomes, the group capital position will weaken, or recent trends may result in certain internal limits being breached, the Lead State examiner should understand what actions the insurer/group expects to take as a result of such an assessment (e.g., reduce certain risk exposure, raise additional capital, etc.). In addition, the Lead State examiner should consider how any planned changes in risk exposure or strategy may affect both the insurer's short- and long-term solvency positions. Finally, the Lead State examiner should consider whether the assumptions and methodologies used in preparing the prospective solvency assessment are consistent with the insurer's business strategy and industry best practices. However, there is no one set of assumptions or methodologies that fit every insurer. Regulators must use professional judgment to assess the reasonability and plausibility of capital model

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inputs and outputs. This is not to suggest that the Lead State examiner should not consider asking questions about the modeling approach used by the insurer, as such questions may provide the insurer an opportunity to elaborate on information provided in the ORSA Summary Report and further the Lead State examiner's understanding.

Documentation for Section III

The Lead State examiner should summarize exam conclusions regarding the insurer's assessment of group risk capital by describing the method used (e.g., internal, external, combination) by the insurer to assess its overall group capital target and its basis for such a decision.

If internal capital models are utilized in the process to assess group risk capital, a discussion of material assumptions and methodologies utilized in calculating capital allocated to individual risk components should be provided. In addition, material assumptions and methodologies utilized in calculating a diversification credit should be discussed. Finally, controls over model validation and/or results of independent testing performed in this area should be discussed.

If external capital models are utilized in the process to assess group risk capital, the Lead State examiner should describe the external capital models utilized and their importance to the insurance group. In addition, a discussion of the stress scenarios and testing applied to the external capital model to account for a wide range of potential events should be provided.

The Lead State examiner should also summarize exam conclusions regarding the prospective solvency assessment provided by the insurance group. This summary should discuss the group's prospective solvency projections and projected changes in risk exposures. For example, the Lead State examiner should discuss the material assumptions and methodologies that the insurer used in performing a prospective solvency assessment and whether the assumptions are consistent with the insurer's overall business plan and strategy. Finally, the Lead State examiner should discuss any material changes in individual risk exposures outlined by the insurer and whether any of the information provided presents concerns to be addressed in the remaining phases of the examination.

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F. ORSA Documentation Template

ORSA Summary Report Examination Results
Insurer XYZ 12/31/XX Examination
Using ORSA Summary Reported Dated XX/XX/XXXX

Section I

Prepare documentation summarizing the results of the risk management framework assessment by addressing each of the five principles set forth in the Guidance Manual. Each assessment should first provide a summary of the Lead State analyst's initial assessment, followed by a summary of the results of Lead State exam procedures, leading to a final exam assessment for each principle. The final Lead State exam assessment should provide adequate rationale for any deviation from the Lead State analyst's initial assessment of the principle.

1. **Risk Culture and Governance—**Governance structure that clearly defines and articulates roles, responsibilities and accountabilities, and a risk culture that supports accountability in risk-based decision-making.

   Initial Lead State Analyst Assessment:

   Summary of Lead State Exam Results:

   Final Lead State Exam Assessment:

   ☐5 ☐4 ☐3 ☐2 ☐1 ☐0

2. **Risk Identification and Prioritization**—Risk identification and prioritization processes are key to the organization. Responsibility for this activity is clear. The risk management function is responsible for ensuring the process is appropriate and functioning properly.

   Initial Lead State Analyst Assessment:

   Summary of Lead State Exam Results:

   Final Lead State Exam Assessment:

   ☐5 ☐4 ☐3 ☐2 ☐1 ☐0

3. **Risk Appetite, Tolerances and Limits—**A formal risk appetite statement, associated risk tolerances and limits are foundational elements of risk management for an insurer. Understanding of the risk appetite statement ensures alignment with risk strategy set by senior management and reviewed and evaluated by the board.

   Initial Lead State Analyst Assessment:

   Summary of Lead State Exam Results:

   Final Lead State Exam Assessment:

   ☐5 ☐4 ☐3 ☐2 ☐1 ☐0

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4. **Risk Management and Controls**—Managing risk is an ongoing ERM activity, operating at many levels within the organization.

   Initial Lead State Analyst Assessment:

   Summary of Lead State Exam Results:

   Final Lead State Exam Assessment:

   ☐5 ☐4 ☐3 ☐2 ☐1 ☐0

5. **Risk Reporting and Communication—** Provides key constituents with transparency into the risk-management processes and facilitates active, informal decisions on risk-taking and management.

   Initial Lead State Analyst Assessment:

   Summary of Lead State Exam Results:

   Final Lead State Exam Assessment:

   ☐5 ☐4 ☐3 ☐2 ☐1 ☐0

Overall Section I Assessment
After considering the assessment of each of the five previously identified principles and taking into account any additional factors that the examiner identified during the review of the ERM framework, develop an overall assessment of the insurer's risk management framework using the same risk maturity model. The assessment, along with findings from Section II and Section III, will assist the examination team in determining the extent of reliance to be placed on the insurer's ORSA/ERM process throughout the remaining phases of a full-scope examination and through modifications to the ongoing supervisory plan. Results should also be provided to the analyst at the conclusion of the examination.

Overall Lead State Assessment Rationale:

☐5 ☐4 ☐3 ☐2 ☐1 ☐0

Section II

Prepare documentation summarizing a review and assessment of information that the insurer provided on its reasonably foreseeable and relevant material risks, and corresponding stress assumptions and test results.

1. Based on your knowledge of the group, did the insurer include in its ORSA a discussion of risks and related stresses that you consider appropriate for the group? **Note whether the following are applicable or not.**

   a. **Credit**—Amounts actually collected or collectible are less than those contractually due or when payments are not remitted on a timely basis.

      Lead State Examiner Summary of Risks and Stress Testing:

   b. **Legal**—Nonconformance with laws, rules, regulations, prescribed practices or ethical standards in any jurisdiction in which the entity operates will result in a disruption in business and financial loss.

      Lead State Examiner Summary of Risks and Stress Testing:

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c. **Liquidity**—This is the inability to meet contractual obligations as they become due because of an inability to liquidate assets or obtain adequate funding without incurring unacceptable losses.

Lead State Examiner Summary of Risks and Stress Testing:

d. **Market—**Movement in market rates or prices (such as interest rates, foreign exchange rates or equity prices) adversely affects the reported and/or market value of investments.

Lead State Examiner Summary of Risks and Stress Testing:

e. **Operational**—The risk of financial loss resulting from inadequate or failed internal processes, personnel and systems, as well as unforeseen external events.

Lead State Examiner Summary of Risks and Stress Testing:

f. **Pricing/Underwriting—**Pricing and underwriting practices are inadequate to provide for risks assumed.

Lead State Examiner Summary of Risks and Stress Testing:

g. **Reputation**—Negative publicity, whether true or not, causes a decline in the customer base, costly litigation and/or revenue reductions.

Lead State Examiner Summary of Risks and Stress Testing:

h. **Reserving**—Actual losses or other contractual payments reflected in reported reserves or other liabilities will be greater than estimated.

Lead State Examiner Summary of Risks and Stress Testing:

i. **Strategic**—Inability to implement appropriate business plans, make decisions, allocate resources or adapt to changes in the business environment will adversely affect competitive position and financial condition.

Lead State Examiner Summary of Risks and Stress Testing:

j. **Other**—Discuss any other reasonably foreseeable and relevant material risks facing the insurer that do not fit into one of the nine branded risk classifications identified above.

Lead State Examiner Summary of Risks and Stress Testing:

Overall Risk Assessment Summary

After considering the various risks that the insurer identified, as well as an analysis of such risks, develop an overall risk assessment summary of possible concerns that may exist.

Section III

Prepare documentation summarizing a review of the group capital assessment and prospective solvency assessment provided by the group as follows:

1. Summarize exam conclusions regarding the insurer's assessment of group risk capital by addressing each of the following elements:

   a. **Overall Method of Capital Measurement**: Discuss the method(s) (e.g., internal, external, combination) that the insurer used in assessing its overall group capital target and its basis for such a decision.

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Lead State Examiner Summary:

b. **Internal Capital Models**: If internal capital models are utilized in the process to assess group risk capital, discuss each of the following items:
   i. Material assumptions and methodologies utilized in calculating capital to be allocated to individual risk components.

      Lead State Examiner Summary:

   ii. Stress scenarios and testing applied to individual risk components.

      Lead State Examiner Summary:

   iii. Material assumptions and methodologies utilized in calculating a diversification credit based on the correlation between risk components.

      Lead State Examiner Summary:

   iv. Controls over model validation and/or results of independent testing performed in this area.

      Lead State Examiner Summary:

c. **External Capital Models**: If external capital models are utilized in the process to assess group risk capital, discuss each of the following items:
   i. External capital models utilized and their importance to the insurance group.

      Lead State Examiner Summary:

   ii. Stress scenarios and testing applied to the external capital model to account for a wide range of potential events.

      Lead State Examiner Summary:

2. Summarize exam conclusions regarding the prospective solvency assessment that the insurance group provided by discussing each of the following elements:

   a. **Prospective Solvency Projections**: Discuss the material assumptions and methodologies that the insurer utilized in performing the prospective solvency assessment. Are assumptions consistent with the insurer's overall business plan and strategy?

      Lead State Examiner Summary:

   b. **Changes in Risk Exposure**: Discuss material changes in individual risk exposures that the insurer outlined. Document whether any of the information provided present concerns to be addressed in the remaining phases of the examination.

      Lead State Examiner Summary:

G. Utilization of ORSA Results in the Remaining Phases of the Examination

The review and assessment of the insurer's ORSA/ERM processes during an on-site examination is meant to provide input and feedback to the Lead State financial analyst for updating the insurer's ongoing supervisory plan and in reaching a final assessment regarding the maturity of the insurer's ERM framework. However, the knowledge that the Lead State

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examiner gains in performing this review and assessment should also be utilized to gain efficiencies, if appropriate, in the seven-phase risk-focused examination process.

The extent to which the Lead State examination team utilizes information from the insurer's ORSA/ERM processes to create efficiencies should depend upon the overall assessment of the insurer's ERM framework as follows:

Maturity Level	Resulting Examination Impact
5	The Lead State examination team may place a high degree of reliance on the insurer's general ERM framework and related controls and may utilize ORSA conclusions to substantially reduce and focus the scope of remaining examination activities.
4	The Lead State examination team may place a moderately high degree of reliance on the insurer's general ERM framework and related controls, while considering additional testing for significant individual controls/strategies. ORSA conclusions may be utilized to reduce and focus the scope of remaining examination activities.
3	The Lead State examination team may place a moderate degree of reliance on the insurer's general ERM framework and related controls, but significant individual controls/strategies should be subject to testing. ORSA information should be considered in limiting and focusing the scope of remaining examination activities.
2	The Lead State examination team may place a low degree of reliance on the insurer's general ERM framework and related controls. Individual controls/strategies should be subject to examination testing. ORSA information should be considered in focusing the scope of remaining examination activities.
1	The Lead State examination team should not place reliance on the insurer's ERM framework and related controls without performing testing on individual controls/processes. ORSA information can be considered in scoping examination activities, but it should be supplemented by additional tools and resources.
0	The Lead State examination team should not place any reliance on nor consider the results of the insurer's ERM/ORSA framework in scoping examination activities.

While this guidance is developed with ORSA-compliant insurers in mind, the concepts may also be applied to non-ORSA companies that have implemented risk management functions. Therefore, the Lead State examination team should customize the consideration of ERM processes during each examination to meet the needs of the insurer being reviewed.

While the results of the ERM maturity assessment can be broadly utilized in customizing risk-focused examination activities, additional guidance has been prepared to provide examples of specific information obtained through the ERM/ORSA review process that may be utilized to reduce or facilitate the remaining phases of the financial examination. The Lead State examination team may be able to utilize information obtained through a review of ERM/ORSA processes to gain exam efficiencies as outlined in the following table:

ERM/ORSA Information	Related Examination Process(es)	Explanation
Section 1 – Description of the Insurer's Risk Management Framework	Phase 1, Part Two: Understanding the Corporate Governance Structure	The Lead State examiner's work to review and assess the insurer's ERM framework (as reported in the ORSA) may be used to satisfy the requirement to review the insurer's risk management practices as part of the Phase 1 corporate governance review. The overall ERM

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		maturity level assessment discussed above should be completed during the planning stage of an exam.
Section I – Risk Identification & Prioritization; Section II – Insurer's Assessment of Risk Exposure	Phase 1, Part Five: Prospective Risk Assessment; Exhibit V – Overarching Prospective Risk Assessment; Phase 2: Identifying and Assessing Inherent Risks	The risks described, prioritized and quantified through the insurer's ERM/ORSA processes should assist the Lead State examiner in identifying and assessing reasonably foreseeable and relevant material risks to be reviewed during the exam.
Section I – Risk Appetites Tolerances and Limits; Section II – Insurer's Assessment of Risk Exposure	Phase 3 – Identify and Evaluate Risk Mitigation Strategies/ Controls; Exhibit V – Overarching Prospective Risk Assessment	Risk tolerances and limits that the insurer sets may represent strategies/controls that can be relied upon to mitigate reasonably foreseeable and relevant material risks in Phase 3 of the examination process or to address overarching prospective reasonably foreseeable and relevant material risks.
Section II – Insurer's Assessment of Risk Exposure; Section III – Group Assessment of Risk Capital	Phase 5 – Establish/ Conduct Detail Test Procedures	The results of stress testing that the insurer performed, as well as the amount of capital allocated to individual risk components, may assist the Lead State examiner in determining the ultimate impact of unmitigated residual risks on the insurer. To the extent that the insurer accepts certain residual risks and capital is allocated to the risk under a wide range of potential outcomes, the Lead State examiner may choose to document this fact in Phase 5 and avoid documenting a finding in this area. However, the documentation should discuss reasonably foreseeable and relevant material risks, capital and liquidity in sufficient detail to address future solvency concerns in these areas.
Section III – Group Assessment of Risk Capital	Exhibit DD – Critical Risk Categories (Capital Management)	The overall results of the group risk capital assessment, as well as the prospective solvency assessment that the insurer performed, should provide evidence of whether the insurer's capital management plans are adequate. This information may be used to address reasonably foreseeable and relevant material risks related to capital management required to be considered by Exhibit DD – Critical Risk Categories.
Section III – Prospective Solvency Assessment	Phase 6 – Update Prioritization & Supervisory Plan; Phase 7 – Draft Exam Report & Management Letter	Information provided in the insurer's prospective solvency assessment should address the insurer's ongoing strategy and business outlook. This information may be useful in reaching overall exam conclusions and determining steps for future monitoring efforts required to be documented in Phases 6 and 7 of the examination.

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SECTION 2—RISK-FOCUSED EXAMINATION PROCESS

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PHASE 1 – UNDERSTAND THE COMPANY AND IDENTIFY KEY FUNCTIONAL ACTIVITIES TO BE REVIEWED

In Phase 1 of a risk-focused examination, key activities will be confirmed or identified using background information gathered on the company from various sources. Some of this information will already have been available in the department prior to the initial planning meeting, or can be obtained from the company's internal audit department or external auditors. A Phase 1 goal is to gather any additional or current information necessary to begin the risk-focused examination. Sources of information may include organizational charts, filings required by sections 302 and 404 of the Sarbanes-Oxley Act of 2002 (where applicable), interviews with senior management, or other publicly available information.

To ensure the appropriate risk-focused examination scope, it is important to identify the key functional activities (i.e., business activities) of the company. Information gathered by understanding the company, the company's corporate governance structure, and assessing the company's audit function will form the basis for determining key activities.

Essential to executing the risk-focused surveillance process is interviewing executive management and possibly board members of the company to identify key activities and risks. Risks identified through these interviews and each part of Phase 1 should be documented on Exhibit CC – Issue/Risk Tracking Template or a similar document to ensure they are carried through the remaining phases of the examination. Examiners and company officials should attempt to maintain an ongoing dialogue to assist the examiners in understanding the company and identifying key functional activities. It is also critical for the examination team to understand and leverage the company's risk management program; that is, how the company identifies, controls, monitors, evaluates and responds to its risks. For companies required to submit an Own Risk and Solvency Assessment (ORSA) summary report to the lead or domestic state, the report provided by the company may be a useful tool in this evaluation. The discipline and structure of risk management programs vary dramatically from company to company. "Best practices" are emerging for risk management programs and more companies are appointing chief risk managers whose responsibilities go well beyond the traditional risk management function (the buying of insurance). The Committee of Sponsoring Organizations (COSO) has published internal control standards that are widely-held, although not required, in many industries and has released an Enterprise Risk Management Integrated Framework, which is anticipated to be incorporated by several entities as well as guidance to apply the integrated framework and internal control standards to small public companies. The examination team should evaluate the strength of the company's risk management process, which can include a "hind-sight" evaluation of why a particular negative surprise or event occurred (i.e., why was it not identified in the current risk management program of the company).

There are five parts to Phase 1 that are key components of performing a risk assessment, the results of which drive the direction of the risk-focused examination: (1) Understanding the Company; (2) Understanding the Corporate Governance Structure; (3) Assessing the Adequacy of the Audit Function; (4) Identifying Key Functional Activities; and (5) Consideration of Prospective Risks for Indications of Solvency Concerns. The Risk Assessment Matrix (Exhibit K), the tool developed to serve as the centralization for the documentation of risk assessment and testing conclusions, should be updated with the identified key activities of the company after the examiner is able to obtain an understanding of the company and corporate governance structure. The five parts of Phase 1 are discussed as follows:

A. Part 1: Understanding the Company
B. Part 2: Understanding the Corporate Governance Structure
C. Part 3: Assessing the Adequacy of the Audit Function
D. Part 4: Identifying Key Functional Activities
E. Part 5: Consideration of Prospective Risks for Indications of Solvency Concerns

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A. Part 1: Understanding the Company

Step 1: Gather Necessary Planning Information

Meet with the Assigned Analyst

Gathering information becomes the first step in gaining an understanding of the company. While general information may have been requested from the company during examination pre-planning through use of Exhibits B and C, the examination team should determine what other information is already available to the department before making additional information requests. To do so, the examination team should meet (in-person or via conference call) with the assigned financial analyst (and/or analyst supervisor) prior to requesting additional information for use in examination planning. An email exchange, in and of itself, is not deemed sufficient to achieve the expectation of a planning meeting with the assigned analyst.

In addition to gaining an understanding of the information already available to the department, the meeting with the analyst should focus on the company's financial condition, prospective risks and operating results since the last examination. The analyst should be asked to discuss risks and concerns highlighted in the Insurer Profile Summary (IPS)/Group Profile Summary (GPS) and to describe the reasons for unusual trends, abnormal ratios and transactions that are not easily discernible. The analyst may also request specific matters or concerns for verification and review during the financial examination. To summarize the input received from financial analysts, the examination team should document risks identified by the analyst for further review on the examination and post significant items to Exhibit CC – Issue/Risk Tracking Template for incorporation into the examination process.

If the company under examination has redomesticated since the prior exam, the department analyst will typically take a primary role in communicating with the prior domestic regulator in order to adequately transfer regulatory insights accumulated over years of oversight. The department analyst would then share these insights with the examiner in charge during the examiner/analyst meeting during the planning phase of the examination. This communication may include a discussion of the Insurer Profile Summary and key risks, the supervisory plan, the former regulator's assessment of Senior Management, the Board of Directors and corporate governance, and other relevant solvency monitoring information. If after meeting with the analyst the examiner requires additional information or further clarification, the examiner may consider contacting the former regulator.

The avoidance of redundancy between analysis and examination processes is of critical importance for an enhanced and more efficient overall regulatory process that will benefit both regulators and industry. An efficient regulatory process fosters clarity and consistency, which results in a better understanding of how individual insurers operate across the different aspects of the regulatory spectrum, including the areas of financial examination, financial analysis and other solvency-related regulation.

By utilizing information and input provided by the analysts, the examination team can request updates to existing information available to the department rather than duplicating requests for information already provided to the analyst. This process eliminates the need for examiners to redevelop the financial analysis information in the examination workpapers so that examination resources may instead be used to update the information while on-site at the insurer. Similar to the benefits of reviewing and using external or internal auditor workpapers, examiners use of detailed financial analysis workpapers in the examination files should result in examinations being more efficient and streamlined.

Gather Information Already Available to the Department

After meeting with the assigned analyst to gain an understanding of company information already available to the department, gather relevant information for use in examination planning. Exhibit A – Examination Planning Procedures Checklist provides examples of information already available to the department that may be relevant for inclusion within the examination file. Information sources may include responses to Exhibit B – Examination Planning Questionnaire, responses to the Information Technology Planning Questionnaire (see Exhibit C – Part One), as well as documentation of ongoing monitoring completed by the insurance department analyst, state insurance departments' and other regulators' reports and information available through public sources.

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Importantly, analysts typically perform procedures and receive documents from the company on several key areas of operation. These may include, but are not limited to, related party transactions, key reinsurance agreements and business plans/projections. Therefore, it is important that examiners and analysts have a comprehensive exchange of information to assist in reducing redundancy during an exam. Depending on the depth of review performed during the ongoing analysis process, this may include more items than those suggested or included in Exhibit B.

Examiners should note, however, that the fact that an analyst has reviewed a transaction or risk exposure does not typically eliminate the need for exam testing procedures. Instead, examiners should gain an understanding of work that has already been performed so that it can be leveraged and incorporated into the seven-phase process.

Obtain Additional Information from the Company
After meeting with the assigned analyst and gathering information already available to the department for review in examination planning, the examination team should determine what additional information is necessary to request from the company to assist in gaining an adequate understanding of the company and the risks it faces. These information requests may include requests for third party reports including SOC reports and security assessments (see Section 1, Part III, F – Outsourcing of Critical Functions for a discussion and description of SOC reports) as well as requests for information from the external auditor. An Examiner Request Log may be used to assist the examiner in requesting information from the company and its service providers, when necessary.

Hold Planning Meetings
After requesting additional information from the company to assist in examination planning, the examination team should be ready to hold meetings to discuss the details of the examination with both internal and external participants.

Internal Planning Meetings
An internal department planning meeting, or meetings, should be held to kick-off the examination and receive and review input regarding the company from other areas of the department. In preparation for this meeting, the exam team should request and receive input on the company from areas outside of solvency regulation, such as market conduct, rates and forms, legal, etc. This information received from other areas of the department should be reviewed to determine the impact on the examination plan, if any. In addition, and if necessary, the internal planning meeting(s) should include a discussion with the in-house (department) actuary to discuss the company's historical reserving issues and extent of data validation required during the examination. This discussion should also cover the topic of actuarial resources to be utilized during the examination. If a discussion with the actuary is not deemed necessary, exam planning documentation should indicate why.

Another significant element of the internal planning meeting(s) is to discuss plans for the examination with the chief examiner or designee. Discussions with the chief examiner or designee should cover:

- Planning materiality and the preliminary examination approach
- The use of specialists (e.g., actuary, information systems, investment, appraiser, IT examiner, reinsurance expert)
- Significant events and department concerns
- Impact of industry conditions and economy on the company and examination plan
- Staffing and experience requirements
- Relationship with the internal and external auditors

Meetings with the Company and Other Regulators
After internal department meetings are completed, the examination team should meet with other affected regulators and the insurance company itself. In preparing to meet with other affected regulators, the examination team should consider the holding company group the company belongs to, if applicable. Obtaining at least a basic understanding of the holding company group and the companies that compose it will assist the examiner in determining key activities and inherent risks of the company to address during the examination. Inquiries and discussions with federal and international regulators are especially vital when conducting examinations of insurers that are part of holding company groups (domestic or internationally) that include a company or companies that are at least in part regulated by other regulators outside of the state insurance regulatory structure. Prior to contacting these regulators, examiners should speak to other regulators in the

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holding company group (e.g., financial analysts, examiners from other states) to determine if communication has already taken place. This will help the examiner decide whether additional inquiries and/or a meeting are necessary to plan the examination. A few basic questions that can be asked include:

- What is your view of the current financial condition of the holding company group and the companies therein?
- Are you aware of any regulatory issues with the holding company group and/or the companies therein?
- Are there any other significant events that may affect the upcoming financial examination?

After meeting with other impacted regulators, the examination team should conduct a planning meeting with the company under examination to discuss relevant issues such as:

- The overall scope, extent and timeline of the planned examination
- Significant changes in the company's operations, major lines of business and corporate governance
- Personnel or systems changes that would significantly affect the areas of accounting, controls, procedures, systems or approval authorities
- Obtaining access to audit workpapers and scheduling a meeting with the external auditor
- Plans for scheduling interviews with key members of management and the board of directors
- Whether the company outsources critical functions to third parties
- Follow-up on requests for additional required reports and records (if necessary)
- The relationship between the company and its internal and external auditors
- Obtaining relevant internal audit reports for review and consideration
- Requesting the trial balance and other accounting records used to prepare annual financial statements

In addition to meeting with the company, the examination team should arrange a meeting with the appointed actuary to review the objectives and scope of the actuary's work and to obtain an understanding of the methods and assumptions used in establishing the actuarially determined asset or liability.

Other Sources of Planning Information

The AICPA publishes audit risk alerts as non-authoritative practice aids designed to be used as engagement planning tools. The alerts are valuable resources for the examiners to consider as they develop an overall examination program. The risk alert series includes the Insurance Companies Industry Developments and General Audit Risk Alerts. The AICPA also publishes Audit and Accounting guides that include a Property and Liability Companies guide and a Life and Health Entities guide.

Consideration of Fraud

A consideration of fraud in financial condition examinations should occur during the planning, testing and reporting phases of the examination. The examiner should begin this assessment during Phase 1 of the examination. To facilitate this assessment, the examiner may utilize Exhibit G – Consideration of Fraud in this Handbook (or a similar document). For additional guidance regarding the consideration of fraud, including a discussion of fraud risk factors, refer to Section 1 in this Handbook.

Consideration of Related Parties

A consideration of related parties should begin in Phase 1 of the examination. Related parties are defined as entities that have common interests as a result of ownership, control, affiliation or by contract. Related party transactions are subject to abuse because reporting entities may be induced to enter transactions that may not reflect economic realities or may not be fair and reasonable to the reporting entity or its policyholders. The examiner's review of the company in Phase 1 includes gaining an understanding of the insurer's significant related party agreements and/or transactions (e.g., pooling agreements, reinsurance contracts, intercompany management and service agreements, tax-sharing agreements, etc.). In gaining this understanding, the examiner should leverage information already obtained by the financial analyst to the extent possible. If necessary, the examiner may confirm directly with the insurer under examination to determine the completeness and accuracy of such information. For additional guidance regarding the consideration of related parties, refer to Section 1, Part IV D in this Handbook.

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Step 2: Review of Gathered Information

The examination team should become familiar with the unique aspects of the company's operations/products, risk management strategies/controls, and future business projections and goals. Initial steps in the planning process include reviewing the following documents to obtain an overview of the company's general regulatory posture with the department and to identify existing areas of regulatory focus:

1. Insurer Profile Summary (IPS) – The Insurer Profile Summary will provide an executive summary of an insurer's financial condition, risk profile, regulatory action/plans and other highlights. The profile format will provide a consistent structure that outlines the status of an insurer or group of insurers from a regulatory perspective at any given time. Each state will maintain a profile for their domestic companies.

2. Group Profile Summary (GPS) – The Group Profile Summary will provide an executive summary of the holding company system, corporate governance, ERM and other highlights incorporated from available filings and resources (e.g., financial filings, Form B, Form F, ORSA Report, Corporate Governance Annual Disclosure [CGAD], transaction filings, etc.) to outline the status of the group from a regulatory perspective. The Lead State takes responsibility for analyzing the group and maintaining the GPS, which it provides to all states with a domestic insurance entity in the group. Each domestic state is responsible for assessing the impact of the holding company on its domestic insurer.

3. General Correspondence and Other Files – Review for significant current period events that may have an impact on assessing comparative prior period work, account balances or future operations.

4. Financial Analysis Annual Financial Statement Review Package, including Examination Jumpstart Profile Report and Analyst Team Reports – Meet with the financial analyst via a face-to-face meeting or conference call to gain an understanding of work performed in the interim period. Specifically, discuss and review significant trends, key solvency ratios and scores (including IRIS ratios and FAST scores) and financial results since the date of the last examination, holding company filings, 10-K Forms, etc., with a greater focus on significant or unusual solvency results or trends. The examiner should focus on understanding what gave rise to variances in the IRIS ratios, not simply the fact that certain ratios are outside the norms. For property/casualty insurers, special attention should be given to the adequacy of loss and loss adjustment expense reserves, as well as the company's reliance on, and the quality of, its reinsurance program. Reserves and reinsurance should be given special attention for life and other types of insurers, as well.

5. Prior Period Workpapers/Reports – A brief review should be performed to obtain a general understanding of work performed in prior periods, overall scope of work, perceived risk areas, and specific findings. The review should focus on key solvency trends and results from previous steps.

6. Financial Projections – Examiners should obtain and review the company's documented business projections and plans, when available, to identify whether significant revisions are planned to the insurer's operations (expansion of products, geographical representation, etc). This review will assist the examiner in identifying prospective operational and financial reporting risks so further inquiry can be completed throughout the examination process.

Significant risks or issues identified through reviewing the gathered information should be documented on Exhibit CC – Issue/Risk Tracking Template or a similar document to ensure they are carried through the remaining phases of the examination.

Step 3: Analytical and Operational Reviews

After meeting with the department's analyst, determine if further analytical and operational review is necessary. In reaching this determination, the exam team should consider the extent of analytical review performed by the analyst, including any relevant information on current period results provided the insurer (e.g., Management Discussion & Analysis [MD&A], company correspondence, etc.), as well as existing analytical tool results available through iSite+. It is

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very common and appropriate that after discussions with the department's analyst, the exam team will determine that no further analytical review is necessary as part of the Phase 1 procedures performed.

The following guidance may be used when existing work is not available or it is not possible to rely on work performed by the financial analyst.

Performing an analytical review involves the study and comparison of relationships among data at a point in time and the trend in those relationships over periods of time. Based on an understanding of a company's business, the examiner develops certain expectations about important financial and operating relationships. Analytical review results that support these expectations increase the level of confidence and may lead to examination efficiencies by changing the nature of tests or by reducing the extent of other procedures. Conversely, analytical review results that differ from expectations should increase overall skepticism and may require additional procedures to explain significant variations from expectations. Use of analytical review as the basis for reduction of detail examination procedures is most appropriate for activities that are determined to have low residual risk, but is not recommended for activities that have high residual risk. Additional guidance on using analytical review procedures in detail testing can be found in Phase 5.

To maximize effectiveness and efficiency, the examiner should select only those relationships that will assist in drawing meaningful conclusions. In designing analytical review procedures, the exam procedure often can be used to gather evidence regarding different examination assertions. For example, a procedure used in Phase 1 to gain an understanding of the company could also be used in Phase 5 as a detail test to help determine the reasonableness of the balance. The uses of analytical review procedures are limited only by the availability of reliable information.

During initial planning, analytical review procedures are directed toward overall financial condition and profitability rather than specific accounts. These procedures are directed toward identifying such things as (1) changes in profitability trends; (2) deterioration in asset quality, liquidity, or capital adequacy; (3) changes in investment strategies; and (4) changes in the number of unauthorized reinsurance agreements. The analytical review may result in the identification of material changes in annual statement balances that would not necessarily trigger further inquiry during the examination, due to work already being performed in this area during financial analysis. If no additional concerns with the fluctuation are identified, the exam team will generally not need to investigate the issue further.

An overall analytical review of annual statement amounts and relationships is one way to update the examiner's understanding of external and internal factors that influence the environment in which the company operates. Among other things, this review should focus attention on significant environmental pressures. An example of a review of environmental pressures would be to review changes in levels of overall interest rates and corresponding deficiency reserve considerations for interest-sensitive products. Asking management to discuss how it would or has responded to such conditions is a significant part of the review process. These analyses should assist in identifying the overall potential for examination problems and in developing the examination plan.

Other analytical steps the examiner-in-charge should perform include operational reviews. This includes evaluating the impact of pervasive factors and performing analyses, as well as holding discussions with management of the company, to gain a better understanding of the following:

a. Significant current events – Significant developments such as a new acquisition, change in key management, litigation, results of revenue agent review, or other items that may affect the company's solvency should be identified and addressed.

b. Company conditions and issues – The examination team should adequately understand the structure and manner in which the company conducts its business to evaluate its solvency. Items such as the following should be considered:

    i. Organizational structure of the entity

    ii. Key markets and product lines

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iii. Major competitors

iv. Key solvency risk factors (i.e., holding significant amounts of low-grade bonds and/or troubled real estate).

c. The examination team should also evaluate industry conditions that could adversely affect the company's prospective ability to remain solvent. Such conditions might include the following areas:

i. Business and economic trends

ii. Competitive environment

iii. Regulatory changes

d. Obtain an understanding of the company's operations by line or book of business based on discussion with management.

Step 4: Consideration of Information Technology Risks

The examiner-in-charge should also become familiar with the general controls surrounding the company's IT environment. Due to technological advancement (e.g., Internet, Intranet and e-commerce), internal control risks could be more pervasive within the IT environment than in other areas within the company. IT requires more technology insight to understand how it impacts the company's operations. Properly assessing IT risk requires appropriate IT training, experience, and technological insight. The examiner-in-charge may want to consider consulting with a specialist who has experience in reviewing IT general controls.

In conducting examinations of insurers that are part of a holding company group, it is important to note that IT general controls may occur at the holding company level. The exam team should seek to coordinate the identification and assessment of prospective risk in accordance with the exam coordination framework and lead state approach outlined in Section 1 of this Handbook. Where possible, in a coordinated examination, the lead state's work on IT general controls should be utilized to prevent duplication of effort and to leverage examination efficiencies.
Section 1, Part III, A – General Information Technology Review outlines the process in which an IT control environment should be reviewed. Exhibit C, Part Two (also located in this Handbook) is one tool the IT examiner can utilize while conducting the IT review. During the IT review, the IT examiner will identify risks that are relevant to the company based on their understanding of the company.

Once risks have been identified, the examiner will request control information from the company and test the appropriate controls within the IT environment. In the event an IT specialist is utilized, communication with the examiner-in-charge is critical throughout the review of IT general controls, especially when it comes to communicating findings of the review and the impact on the financial examination. As explained in Section 1, Part III, A – General Information Technology Review, the IT specialist should determine whether the IT general controls environment is effective or ineffective. It is important for the examiner to review and understand the conclusion reached by the IT specialist in order to determine the extent of testing that may be required in later phases of the exam. If necessary, the IT specialist may need to assist in completing the work on the financial examination, such as identifying and testing IT application controls.

Consideration and review of the IT environment may be customized based on the size and complexity of the insurer under examination. For additional detail, refer to Section 1, Part III – General Examination Considerations.

Step 5: Update the Insurer Profile Summary

Based upon the review and analysis performed up to this point, provide updates to the analyst regarding any significant initial findings for incorporation into the Insurer Profile Summary (IPS). Updates to the IPS can be suggested throughout the examination process.

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B. Part 2: Understanding the Corporate Governance Structure

This section's purpose is to assist the examiner in documenting the understanding and assessment of an insurer's board of directors and management. A favorable overall assessment of governance does not, by itself, serve to reduce the scope or extent of examination procedures; rather, specific governance controls need to be assessed for their adequacy in managing specific risks, in conjunction with other controls designed to manage the same. See Exhibit M – Understanding the Corporate Governance Structure for additional guidance in understanding the corporate governance structure of the company. When completing this assessment, the examiner should utilize the Corporate Governance Annual Disclosure (CGAD), which is required to be filed with the Department of Insurance (DOI) annually in accordance with *Corporate Governance Annual Disclosure Model Act* (#305) and *Corporate Governance Annual Disclosure Model Regulation* (#306). The CGAD provides a narrative description of the insurer's or insurance group's corporate governance framework and structure and may enhance examination efficiencies when leveraged. Examiners should inquire of the financial analyst to gain an understanding of and leverage the analyst's work in assessing the company's corporate governance.

Effectively structured and competent governance independently involved in a company's risk management activities is an essential element in creating and nurturing a self-sustaining risk management culture. The use of specific corporate governance features may be different for entities that are the ultimate parent corporation from those of subsidiary companies. Components of effective corporate governance programs include:

1. Adequate competency (industry experience, knowledge, skills) of members of the board of directors;
2. Independent and adequate involvement of the board of directors;
3. Multiple, informal channels of communication between board, management and internal and external auditors to create a culture of openness;
4. A code of conduct established in cooperation between the board and management, which is reviewed for compliance and is formally approved by senior management;
5. Identification and fulfillment of sound strategic and financial objectives, giving adequate attention to risks;
6. Support from relevant business planning and proactive resource allocation;
7. Support by reliable risk-management processes across business, operations and control functions;
8. Reinforcement of corporate adherence to sound principles of conduct and segregation of authorities;
9. Independence in assessment of programs and assurance as to their reliability;
10. Objective and independent reporting of findings to the board or appropriate committees thereof;
11. Adoption of Sarbanes-Oxley provisions, regardless of whether mandated, including, but not limited to, auditor independence and whistle-blower provisions; and
12. Board oversight and approval of executive compensation and performance evaluations.

Board of Directors

The control environment and "tone at the top" are influenced significantly by the entity's board of directors and audit committee. Factors include the board or audit committee's independence from management, experience and stature of its members, extent of its involvement and scrutiny of activities, and the appropriateness of its actions. Another factor is the degree to which difficult questions are raised and pursued with management regarding plans or performance. Interaction of the board or audit committee with internal and external auditors is also a factor affecting the control environment.

Interviews of one or more members of the board of directors should be conducted to the extent necessary to identify and assess the "tone at the top." Additionally, the examiner-in-charge and appropriate insurance department personnel may

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wish to meet or otherwise converse with the board or the audit committee at the commencement of an exam or any other appropriate juncture. Various factors may warrant such a meeting and include but are not limited to:

- Significant fraud uncovered at the company;
- Significant senior management changes or turnover;
- Questions the examiner-in-charge may have after reviewing the board meeting minutes; and
- Changes in the external auditor.

Specific factors do not have to exist to warrant such meetings. A meeting with the board or audit committee may take place to obtain an overview of their general functions and responsibilities. These meetings may also facilitate cooperation by management during the exam and assist in the understanding of the company and is another benefit of a top down approach. Examiners should consider the overall structure and operations of the board of directors or audit committee in determining whether a meeting would be beneficial to the examination process.

Because of its importance, an active and involved board of directors, board of trustees or comparable body – possessing an appropriate degree of management, technical and other expertise coupled with the necessary stature and mindset so that it can adequately perform the necessary governance, guidance and oversight responsibilities – is critical to effective internal control. And, because a board must be prepared to question and scrutinize management's activities, present alternative views and have the courage to act in the face of obvious wrongdoing, it is necessary that the board contain outside directors. Although officers and employees are often highly effective and important board members that bring knowledge of the company to the table, there must be a balance. Although small and even mid-size companies may find it difficult to attract or incur the cost of having a majority of outside directors, it is important that the board contain at least a critical mass of outside directors. The number should suit the entity's circumstances, but more than one outside director would normally be needed for a board to have the requisite balance. A board composed entirely (or principally) of officers of the company (or relatives or friends of the owner or management) cannot be viewed as capable of sufficient, independent oversight of the insurer operations.

Management is accountable to the board of directors or trustees, which provides governance, guidance, and oversight. By selecting management, the board has a major role in defining what it expects in integrity and ethical values, and can confirm its expectations through its oversight activities. Similarly, by reserving authority in certain key decisions, the board can play a role in high-level objective setting and strategic planning. In addition, with the oversight that the board provides, the board is pervasively involved in internal control.

Effective board members are objective, capable and inquisitive. They have a working knowledge of the entity's activities and environment, and commit the time necessary to fulfill their board responsibilities. They should utilize resources as needed to investigate any issues they deem important. They should also have an open unrestricted communication channel with all entity personnel, including the internal auditors, and with the external auditors and legal counsel. The sufficiency of the diligence of the board is reflected in the substance of the minutes or supporting documentation.

Many boards of directors carry out their duties largely through committees. Their use and focus vary from one entity to another, but often include audit, compensation, finance, nominating, and employee benefits. Each committee can bring specific emphasis to certain components of internal control. For example, the audit committee has a direct role in internal control relating to financial reporting, and the nominating committee plays an important role in internal control by its consideration of qualifications of prospective board members. In fact, all board committees, through their oversight roles, are an important part of the internal control system. Where a particular committee has not been established, the related functions are carried out by the board itself.

Audit Committee

Over the years, attention has been given by a number of regulatory and professional bodies to establishing audit committees. Although audit committees have received increased emphasis over the years, they are not universally required, nor are their specific duties and activities prescribed. Audit committees of different entities have different responsibilities, and their levels of involvement vary.

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Although some variations in responsibilities and duties are necessary and appropriate, certain characteristics and functions generally are common to all effective audit committees. Management is responsible for the reliability of the financial statements, but an effective audit committee plays an important role. The audit committee (or the board itself, where no audit committee exists) has the authority to question top management regarding how it carries out its financial reporting responsibilities, and also has authority to ensure that corrective action is taken. The audit committee, in conjunction with or in addition to a strong internal audit function, is often in the best position within an entity to identify and act in instances where top management overrides internal controls or otherwise seeks to misrepresent reported financial results. Thus, there are instances where an audit committee, or board, must carry its oversight role to the point of directly addressing serious events or conditions.

There have been longstanding audit committee requirements for public companies as set forth by SOX; however, recent modifications to the NAIC *Annual Financial Reporting Model Regulation* (#205)—also known as the Model Audit Rule (MAR)—have set forth audit committee requirements for non-public insurers that exceed the annual premium threshold. The requirements set forth by both SOX and MAR require an audit committee be formed that external auditors report to that audit committee, as well requiring certain levels of independence within the Audit Committee. Examiners should ensure that insurers are complying with these regulations as part of their examination procedures.

Other Committees

There may be other committees of the board which oversee specific functional areas of the company, such as underwriting, strategic planning, ethics, public policy or technology. Generally, these committees are established only in certain large organizations, or in other enterprises due to particular circumstances of the entity.

The board may have a compensation committee which makes recommendations for the compensation (including salary, bonuses and stock options) of senior management of the company. If such a committee is established, it should be composed of outside directors.

Management

Interviews with senior management at the "C" level should be used at the beginning of the examination or at any time during the examination as necessary. "C" level management that may include the CEO (Chief Executive Officer), CFO (Chief Financial Officer), COO (Chief Operating Officer), CIO (Chief Information Officer), CRO (Chief Risk Officer), Controller, Chief Actuary or other appropriate executive-level management. Examiners should consider the size of the organization in determining which individual would provide the examiner with the most beneficial information regarding the company for the stage of the examination. This interview process is a key step in the "top down" approach, beginning with senior management and then drilling down through the various levels of management to obtain a thorough understanding of the organization to assist in scoping the examination. Topics of these high-level interviews should include, but not be limited to (1) corporate strategic initiatives; (2) external/environmental factors of concern to management; (3) political/regulatory changes that might affect business; (4) competitive advantages/disadvantages; (5) management of key functional activities; and (6) how management establishes and monitors the achievement of objectives.

The examiners should consider which individuals should be interviewed and the sources of data to be evaluated to complete each planning step. In order to select the individuals to interview, the examiners should obtain an organizational chart from the company and compile a list of potential interviewees. In addition to accounting department personnel, the interview list should include managers of key functional business units (depending on the company structure, lines of business or revenue centers might be more appropriate). Because all companies have different organizational structures, it is important that the interview schedule and the examination plan match the company. Examiners should form their objectives, or what they want to get out of the interview, prior to conducting the interview. In order to accomplish this, the examiner should have a basic knowledge of the job function of the person that they are interviewing. This will allow the examiner to ask relevant questions and get the most information possible in one setting, as it may be difficult to coordinate multiple contacts with a "C"-level interviewee or a member of the board of directors. The information contained in Exhibit Y – Examination Interviews provides some basic questions that an examiner may consider when conducting "C"-level interviews. Exhibit Y, however, does not provide examples for functional positions at the insurer (e.g., claims handling, sales and marketing, etc.). These functional interviews are typically best documented in a narrative format and may be done in conjunction with walkthroughs or other control documentation procedures. Exhibit CC – Issue/Risk

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Tracking Template may be used in conjunction with Exhibit Y to document significant risks or concerns accumulated during the interview process.

Management's philosophy and operating style affect the way the enterprise is managed, including the kinds of business risks accepted. An entity that has been successful taking significant risks may have a different outlook on internal control than one that has faced harsh economic or regulatory consequences as a result of venturing into dangerous territory. An informally managed company may control operations largely by face-to-face contact with key managers. A more formally managed company may rely more on written policies, performance indicators and exception reports.

Other elements of management's philosophy and operating style include attitudes toward financial reporting, conservative or aggressive selection from available alternative accounting principles, conscientiousness and conservatism with which accounting estimates are developed, and attitudes toward information systems and accounting functions and personnel.

Management is directly responsible for all activities of an entity, including its internal control system. Naturally, management at different levels in an entity will have different internal control responsibilities. These will differ, often considerably, depending on the entity's characteristics.

The chief executive has ultimate ownership responsibility for the internal control system. One of the most important aspects of carrying out this responsibility is to ensure the existence of a positive control environment. More than any other individual or function, the chief executive sets the "tone at the top" that affects control environment factors and other components of internal control. The influence of the CEO on an entire organization cannot be overstated. What is not always obvious is the influence a CEO has over the selection of the board of directors. A CEO with high ethical standards can go a long way in ensuring that the board reflects those values. On the other hand, a CEO who lacks integrity may not be able, or willing, to obtain board members who possess it. Effective boards and audit committees also will look closely at top management's integrity and ethical values to determine whether the internal control system has the necessary critical underpinnings.

The chief executive's responsibilities include seeing that all the components of internal control are in place. The CEO generally fulfills this duty by:

1. Providing leadership and direction to senior managers. Together with them, the CEO shapes the values, principles and major operating policies that form the foundation of the entity's internal control system. For example, the CEO and key senior managers will set entity-wide objectives and broad-based policies. They take actions concerning the entity's organizational structure, content and communication of key policies, and the type of planning and reporting systems the entity will use.

2. Meeting periodically with senior managers responsible for the major functional areas—sales, marketing, production, procurement, finance, human resources, etc.—to review their responsibilities, including how they are controlling the business. The CEO will gain knowledge of controls in their operations, improvements required and status of efforts underway. To discharge this responsibility, it is critical that the CEO clearly define what information is needed.

Senior managers in charge of organizational units have responsibility for internal control related to their units' objectives. They guide the development and implementation of internal control policies and procedures that address their units' objectives and ensure that they are consistent with the entity-wide objectives. They provide direction, for example, on the unit's organizational structure and personnel hiring and training practices, as well as budgeting and other information systems that promote control over the unit's activities. In this sense, in a cascading responsibility, each executive is effectively a CEO for his or her sphere of responsibility.

Senior managers usually assign responsibility for the establishment of more specific internal control procedures to personnel responsible for the unit's particular functions or departments. Accordingly, these subunit managers usually play a more hands-on role in devising and executing particular internal control procedures. Often, these managers are directly responsible for determining internal control procedures that address unit objectives, such as developing authorization

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procedures. They will also make recommendations on the controls, monitor their application and meet with upper level managers to report on the controls' functioning.

Depending on the levels of management in an entity, these subunit managers, or lower level management or supervisory personnel, are directly involved in executing control policies and procedures at a detailed level. It is their responsibility to take action on exceptions and other problems as they arise. This may involve investigating data entry errors or transactions appearing on exception reports, or looking into reasons for departmental expense budget variances. Significant matters, whether pertaining to a particular transaction or an indication of larger concerns, are communicated upward in the organization.

With each manager's respective responsibilities should come not only the requisite authority, but also accountability. Each manager is accountable to the next higher level for his or her portion of the internal control system, with the CEO ultimately accountable to the board.

Although different management levels have distinct internal control responsibilities and functions, their actions should coalesce in the entity's internal control system.

Financial Officers

Of particular significance to monitoring functions are finance and controllers' offices and their staffs, whose activities cut across, up and down the operating and other units of an enterprise. These financial executives are often involved in developing entity-wide budgets and plans. They track and analyze performance, often from operations and compliance perspectives, as well as from a financial perspective. These activities are usually part of an entity's central or "corporate" organization, but they commonly also have "dotted line" responsibility for monitoring division, subsidiary or other unit activities. As such, the chief financial officer, chief accounting officer, controller and others in an entity's financial function are central to the way management exercises control.

The importance of the role of the chief accounting officer in preventing and detecting fraudulent financial reporting was emphasized in the Treadway Commission report: "As a member of top management, the chief accounting officer helps set the tone of the organization's ethical conduct, is responsible for the financial statements; generally has primary responsibility for designing, implementing and monitoring the company's financial reporting system; and is in a unique position regarding identification of unusual situations caused by fraudulent financial reporting." The report noted that the chief financial officer or controller may perform functions of a chief accounting officer.

When looking at the components of internal control, it is clear that the chief financial (or accounting) officer and his or her staff play critical roles. That person should be a key player when the entity's objectives are established and strategies decided, risks are analyzed and decisions are made on how changes affecting the entity will be managed. He or she provides valuable input and direction, and is positioned to focus on monitoring and following up on the actions decided.

Enterprise Risk Management

One aspect of a company's corporate governance is enterprise risk management (ERM). The way a company identifies, monitors, evaluates and responds to risks can be very important to the ongoing solvency of the company. ERM is, therefore, an important area for an examiner to review during the course of the examination. Exhibit M – Understanding the Corporate Governance Structure contains a section with specific areas of consideration in reviewing the risk management function. For large companies subject to the requirements of the ORSA, the summary report provided by the company may be used in the evaluation of risk management. Examiners should complete the ORSA Documentation Template located in Section 1, Part XI of this Handbook in conjunction with the review of the ORSA summary report.

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C. Part 3: Assessing the Adequacy of the Audit Function

Well-planned, properly structured audit programs are essential to a strong corporate risk management process. Effective internal and external audit activities create a critical monitoring control against fraud, provide vital information to the board of directors (or audit committee) about the effectiveness of internal control systems and mitigate operating and financial reporting risk. Examiners should assess and draw conclusions about the adequacy of internal and external audit as part of the corporate risk management process. The conclusions reached from the assessment will significantly influence the scope and the extent of examination activities at the insurer. The guidance in this section pertains to both external and internal audit functions unless specifically identified.

The following guidelines direct the assessment of insurer audit activities:

1. The board of directors and senior management cannot delegate their responsibilities for establishing, maintaining, and operating effective audit activities (e.g., establishment of an annual audit plan that is reviewed by the audit committee).

2. Examiners must assess the adequacy of an insurer's audit function.

3. Insurer audit activities will be performed by independent and competent staff that is objective in assessing and evaluating the insurer's risks and controls.

Effective audit functions have these characteristics:

1. Provide objective, independent input on operating and financial reporting risks and internal controls, including management information systems.

2. Help maintain or improve the effectiveness of insurer risk management processes, controls and corporate governance.

3. Provide reasonable assurance about the accuracy and timeliness with which transactions are recorded and the accuracy and completeness of financial regulatory reports.

4. Provide assistance, guidance or suggestions in areas where needed.

Audit functions may comprise several individual audits that provide various types of information to the board of directors (or audit committee) about the insurer's financial condition and effectiveness of internal control systems. The most common types of audits are financial, operational, compliance, and information technology audits.

One of the objectives of this Handbook is to develop an efficient risk-focused examination approach that provides for more timely detection of potentially troubled insurance companies by focusing examination resources on those companies, or areas within companies, that have a higher likelihood of impact to the financial solvency of the company. Examiners can enhance efficiency in the examination through appropriate communications with the company's auditors, including but not limited to the nature, extent and timing of their audit procedures, any internal control testing and attestations performed (e.g., Sarbanes-Oxley, Model Audit Rule) and their views of the company and its risks. The extent to which the examiner chooses to consider the work of an auditor in performance of the examination is a matter of judgment by the examiner. In situations where the examiner determines that an effective external and/or internal audit function is in place at the insurer, the examination team may choose to identify fewer financial reporting risks for review. Conversely, when an insurer's audit function is found to be inadequate, the examination team may elect to review more risks relating to the accuracy of financial reporting. See Exhibit E – Audit Review Procedures for additional guidance to follow when placing reliance on the work performed by auditors.

Before using an external auditor's work, it is important to first have a basic understanding of the environment in which the external auditor operates.

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External auditors may be engaged by their insurance company clients to perform, among other services, independent audits of the company in accordance with Generally Accepted Auditing Standards (GAAS) as promulgated by the American Institute of Certified Public Accountants (AICPA) or the standards of the Public Company Accounting Oversight Board (PCAOB).

The established auditing standards state, "The objective of the ordinary audit of financial statements by the independent auditor is the expression of an opinion on the fairness with which they present fairly, in all material respects, financial position, results of operations, and its cash flows in conformity with generally accepted accounting principles." In many instances, the states require that the audit be performed on statutory financial statements in conformity with accounting practices prescribed or permitted by the domiciliary state.

Although there are several similarities between the financial reporting risk and control objectives of an external auditor and an examiner, differences may also exist. Depending on the company involved and the nature of the external auditor's engagement, such differences may be significant, even in those situations where the external auditor is reporting pursuant to a state audit rule that may otherwise minimize such differences by requiring a separate company (as opposed to consolidated) audit report on statutory-basis (as opposed to generally accepted accounting principles, or GAAP) financial statements. Examiners and external auditors both need to assess the internal and external environment risks affecting the company (inherent risk), the ability of the company's internal controls to identify and rectify potential material errors in account balances or transactions (control risk/control assessment), and the adequacy of their respective audit or examination procedures to identify such material errors that may exist (detection risk). How the examiner or external auditor addresses these issues during an examination or audit, and the resulting impact on their assessment of materiality and their determination of examination or audit procedures, will reflect their respective experience, training, professional judgment, and overall objectives.

Given the potential for differences that may exist between an external auditor and an examiner, there are areas where their approach, scope of work, procedures and desired documentation will converge. These areas provide opportunities for efficiencies that the examiner should utilize. For publicly held companies, in addition to standards of the PCAOB, the federal Sarbanes-Oxley Act, which requires the external auditor to attest to management's assertion of adequate financial reporting internal controls, provides a significant opportunity for the examiner to place reliance on work completed by the company and/or external auditors. In addition, external auditors are required to adhere to the Risk Assessment Standards (SAS 104 – SAS 111) for non-public companies in order to comply with GAAS. The implementation of the Risk Assessment Standards requires auditors to gain an in-depth understanding of controls associated with financial reporting to identify potential risks based on that understanding and to determine what the insurer is doing to mitigate those identified risks. Companies are making a significant effort to perform a risk-focused, detailed analysis of their financial reporting risks and controls, and to test those controls. Internal auditors, in many cases, and external auditors will perform tests on these processes and selected controls, to allow the external auditor to issue their attestation. The requirements of Sarbanes-Oxley and the Model Audit Rule have also "raised the bar" on external auditor independence, restricting certain activities such as client internal audit outsourcing and financial system implementation project work.

To identify other areas for potential examination efficiencies relating to work performed by an external auditor, the examiner should have an adequate understanding of the overall audit scope, and for areas identified by either the examiner or the external auditor as having a higher likelihood of material error, an understanding of the external auditor's procedures and results thereof.

An internal audit function is also a valuable resource for the examiner to utilize. Similar to their external counterparts, internal auditors should also be independent and provide objective input regarding a company's processes, controls and corporate governance. But internal audits may extend beyond financial reporting of the company and may include operational, compliance and information technology audits. The Institute of Internal Auditors provides a framework of standards for performing and promoting internal auditing. To be fully independent for purposes of exam reliance, internal auditors should report directly to the Audit Committee or Board of Directors instead of company management and should not assume any management responsibility.

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Notification of Examination

Prior to the beginning of the examination, the examiner should notify the external auditor, with the assistance of company personnel, that an exam is upcoming and that the external audit work, along with any SOX or MAR work will be requested. This will allow the auditor to adjust the audit schedule, as needed, so that the external audit work will be available for the examiner as early as possible. This communication to the external auditor is recommended to occur at least six months prior to the exam as-of date, if possible. The exam team may consider asking both the external auditor and the internal auditor to focus the audit on areas of interest to the examiner that would provide efficiencies for the examination. The external auditor may also allow examiners to participate on work performed during an interim period, if appropriate.

Decision Whether to Utilize the Work of Auditors

Communication with the auditors will be helpful throughout the examination process. Auditors may have already identified the functional activities in an organization, assessed risks and controls, and performed detail and control testing that may be relied upon by the examiner. The examiner-in-charge should consider the work performed by both the external and internal auditors and meet with them during the planning phase of the exam. Reliance may be placed on the work performed by auditors if reasonable assurance is obtained that the audit function is independent, objective and conducts quality audits.

In order to obtain sufficient evidence to conclude that the work of the auditor may be relied upon, examiners should conduct a planning meeting with the auditors. To prepare for the initial meeting with an external auditor, the examiner should request, read and review several documents provided by the external auditor for each year since the last examination. These documents include signed audit reports—including audited financial statements, management letters, and management representation letters—and a listing of recorded and unrecorded audit adjustments, if available. At this point in the planning process, the examiner should be far enough along to have formed some tentative conclusions as to which areas of the company may represent key activities and have a higher likelihood of material error in surplus. The planning meeting with the external auditors should include key members of the engagement team, such as the engagement partner or manager, to ensure the information is sourced through those with the most knowledge and understanding of the insurer and its financial statements.

In conjunction with the planning meetings with the auditors, Exhibit E – Audit Review Procedures should be utilized by examiners to document a review of the work performed by the audit function. The review should be kept at a high level but should be sufficient enough to conclude on the scope, adequacy and quality of the audit(s) performed as well as the appropriateness of the conclusions and the consistency of the conclusions within the independent auditor's report. Specific documentation of internal controls and auditor testing should not be reviewed in depth at this point because the examiner is only determining if the work can be relied upon. The examiner will perform a detailed review of these items in Phases 3 and 5 of the exam process if the work is deemed reliable.

Some of the key factors to consider for both external and internal audit functions when performing this review of the auditor and its workpapers are as follows:

- The independence, education, experience and general competence of the auditors involved in the audit.
- The function is adequately staffed with competent professionals.
- The reasonableness of the auditor's assessment of risk, materiality, overall audit scope and findings.
- Workpapers are complete and organized in a logical manner including scope, audit steps, report and documentation to support findings and show evidence of supervisory review.
- Adherence to auditing standards promulgated by the American Institute of Certified Public Accountants (for external auditors) and the Institute of Internal Auditors (for internal auditors).
- Significant findings, corrective management action and status of open issues are communicated to the audit committee.

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A few additional key factors that may indicate the internal audit function is independent are as follows:

- The head of internal audit reports directly to the audit committee on audit matters and may have a dotted line report into the CEO or CFO for daily matters (or similar structure).
- The audit plan is submitted to and approved by the audit committee.
- The internal audit function does not perform any operational functions within the organization.

Additionally, the examiner should specifically identify any noted issues of deliberate improper financial reporting identified by the external auditors in accordance with AU Sec. 316.

To complete the review of auditor work, the examiner should request relevant workpapers of the auditor for the years under examination and perform a review of these workpapers. In addition to reviewing current year working papers, the examiner may find reviewing the prior-year workpapers beneficial if the auditor had considered and documented specific internal controls in the prior year (see guidance in Phase 3 on reliance on control testing performed in prior periods). Obtaining the prior period workpapers is especially important in situations where current-year workpapers may be unavailable due to timing or other reasons, or if controls have been tested on a rotational basis. The examiner should give the auditor at least two weeks notice to provide the workpapers requested for review. Additional meetings with the auditor may be warranted if questions arise or additional audit documentation is necessary. Additional discussions held with the auditor and separate conclusions on the work of the external and internal auditors as to whether reliance is appropriate should be documented in the exam workpapers.

Examiners should be aware that the external auditor may perform procedures at both an interim period and at year-end. In preparing for an examination, examiners should request access to all available audit documentation, including interim workpapers or audit documentation that may not be considered complete. Should the external auditor not cooperate with the examiners in providing completed workpapers upon request, the examiner should request the assistance of company management in obtaining this information. If unsuccessful, the examiner would contact the following individuals in this suggested order, if necessary: (1) the engagement partner; (2) the designated national firm representative; (3) the Chair of the insurer's audit committee; and (4) the State Board of Accountancy, Ethics (or Qualitative Review) Committee, or other regulatory bodies deemed appropriate. The department should determine appropriate action against the company and/or public accounting firm as permitted in accordance with the provisions of the NAIC Model Audit Rule. The provisions of this Model obligate insurers to require their external auditor to make available to the insurance department all workpapers prepared in the conduct of the auditor's examination and any communications related to the audit between the accountant and insurer. The external auditor must agree to make available for review the audit workpapers. If such workpapers are not furnished, an insurance department whose state has adopted the NAIC model regulation may take any remedial action permitted by state law against the insurer and/or the auditor for such an infraction. Until the audit report is released and the workpapers are completed and reviewed, such workpapers are considered incomplete and are subject to change. AICPA Professional Standards indicate that when an audit has not been completed, the audit documentation is necessarily incomplete because (a) additional information may be added as a result of further tests and review by supervisory personnel and (b) any audit results and conclusions reflected in the incomplete audit documentation may change. Although the AICPA Professional Standards indicate that it is preferable that access be delayed until all auditing procedures have been completed and all internal reviews have been performed, auditors have communicated that they are generally willing to provide audit work to the examiner before the audit is finalized, as long as the work has been fully reviewed. When workpapers are furnished to the examiner prior to the completion of the audit, it is recommended that the examiner subsequently follow up with the auditor regarding any changes made to this documentation. Further, the examiner should obtain any workpapers that may have changed. In the circumstance where access to workpapers is not provided prior to the completion of the audit, the examiner is still encouraged to meet with the auditor to discuss the external audit approach.

If access to interim external auditor workpapers is granted, the examiner should evaluate the procedures performed at the interim date. The evaluation of the external auditor's interim work should include an understanding of the areas tested by the external auditor and all respective findings and conclusions. Alternatively, if interim external auditor workpapers are not available, the external auditor's planned audit procedures should be considered by the examiner.

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In reviewing interim audit documentation the examiner should consider the timing of the interim testing in relation to the balance sheet date. For example, detection risk (the risk that misstatements go undetected by the auditor) increases when procedures are performed before the balance sheet date. Detection risk continues to increase as the period between the interim date and balance sheet date increases. Detection risk can be reduced if the tests performed for the remaining period are designed to provide a reasonable basis for extending the interim audit conclusions to the balance-sheet date. The external auditor tests should be designed to cover the remaining period in such a way that the assurance from those tests, the interim test-work, and the assessed level of control risk achieve the audit objective at the balance sheet date. Typically, auditors conduct a comparison of the account at the balance sheet date and the interim date to determine if the account fluctuated in accordance with expected activity. Analytical procedures or detail tests may be used to roll the testing forward to year-end; however, the examiner should always use professional judgment when evaluating and relying on the work performed by the external auditor.

Utilization of the Work of Auditors

As noted above, to the extent that the audit function is determined to be effective, the examination team may place greater reliance on the work of auditors by identifying fewer financial reporting risks for review during the examination. However, for risks that are deemed significant, the examination team may also utilize the work of auditors by obtaining, reviewing and referencing specific work performed by the auditors in the detail workpapers. For example, in Phase 3 and Phase 5 of the examination process, the examiner may incorporate the work of the auditors into the examination workpapers to provide documentation of internal controls and evidence of control and detail testing. Utilizing the work of the auditors expedites the examination by avoiding a duplication of efforts. The auditors' work may be informative to the examiner in efficiently obtaining an understanding of the following matters:

1. The internal control structure: This Handbook requires the examiners to gain an understanding of controls as they relate to specific control objectives for an insurer. To the extent that the auditor may have also reviewed and documented internal controls or flowcharted a particular system, such work should be useful to the examiner.

2. Risk assessment: At the financial statement level or account-balance or class-of-transaction level, the auditor's work should provide information about the effectiveness of internal control structure policies and procedures that might affect the nature or extent of testing the examiner would otherwise need to perform.

3. Compliance and detail procedures: Procedures performed by the auditor may provide direct evidence about the operating effectiveness of controls and material misstatements in specific account balances or classes of transactions. The results of these procedures can provide evidence the examiner may utilize in reducing the extent of procedures or account verification considered necessary.

Although the external auditor has provided an opinion on the presentation of the financial statements taken as a whole, the responsibility to report on the company's solvency status in the form of a statutory examination rests solely with the examiner. Because the examiner has the ultimate responsibility to report on the examination, judgments about assessments of inherent and control risks, the materiality of misstatements, the sufficiency of tests performed, the evaluation of significant accounting estimates and other matters affecting the examiner's report should always be considered in the examiner's assessments. In making judgments about the magnitude of the effect of the external auditor's work on the examiner's procedures, the examiner should consider:

1. The materiality of financial statement amounts (including misstatements encountered by the external auditor that fall below the materiality level for the audit but which may be material to the examiner).

2. The risk (inherent and control risk) of material misstatement related to these financial statement amounts.

3. The degree of subjectivity involved in the evaluation of the audit evidence gathered.

As the materiality of the financial statement amount and the risk of material misstatement or degree of subjectivity increases, the need for the examiner to perform tests may increase. Similarly, as those factors decrease, the need for the examiner to perform tests may decrease.

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Although examiners are encouraged to utilize work performed by auditors for financial statement areas that could directly impact the financial solvency of the company, consideration of the auditor's work may not reduce examination risk to an acceptable level to eliminate the necessity of performing tests of those areas directly by the examiner. Valuation of assets and liabilities involving significant accounting estimates, related party transactions, and contingencies and uncertainties are examples of areas that might have a high risk of material misstatement or involve a high degree of subjectivity in the evaluation of audit evidence. Examiners should consider the auditor's scope of work performed to determine whether and to what extent, they can rely on the work performed by the auditor.

For financial statement areas where the risk of material misstatement or the degree of subjectivity involved in the evaluation of the audit evidence is low, the examiner may enhance examination efficiencies by utilizing the work completed by the auditor without completing additional testwork.

The examiner must exercise professional judgment in utilizing the work of the auditor and in developing examination procedures. Retesting the auditor's work depends on the circumstances and is a matter of professional judgment but should be considered in relation with the amount of reliance placed on the work of the auditor.

Utilization of Company-performed Testing

In addition to using the work of auditors, circumstances may present the opportunity to utilize work performed by non-independent employees of an insurer during an examination. During the planning process, the examiner may identify work performed by risk managers, quality-assurance staff or other employees that would be applicable to the examination and that was used for: 1) complying with the federal Sarbanes-Oxley Act, the Model Audit Rule, COBIT and/or the insurer's enterprise risk-management framework; or 2) general internal control purposes. When this work is utilized, the examiner should recognize that the work is not performed by an independent third party and, as such, requires a higher level of professional skepticism during review. The examiner must exercise judgment to determine the amount of reliance placed on work performed by these individuals and, as such, the examiner may need to perform a more detailed review and/or retesting of the work before placing reliance on it. When making this determination, considerations may include the qualifications of the personnel performing the work, any potential bias by the personnel performing the work and the overall risk attributed to the area under review. The initial determination of the examiner's ability to place reliance on this type of work for the company being examined should be documented in the planning memo, and specific conclusions about reliance and utilization of individual tests should be documented on the related workpapers.

D. Part 4: Identifying Key Functional Activities

To ensure the appropriate risk-focused examination scope, it is important to identify the key functional activities (i.e., business activities) of the company. The information gathered to this point will form the basis for this determination. Note that the list of functional activities may include both other than financial reporting (operating) and financial reporting risks. The insurance organization may be examined on the same basis, as it manages risk and controls itself, so that functional activities listed on a risk matrix would correspond organizationally to the insurer.

When determining what to select as key functional activities, the examiner should perform a preliminary analysis of the overall materiality of an activity. The examiner should carefully consider the risk of understatement when reviewing the materiality of liability balances. If the examiner determines that a particular activity does not currently appear to be material, but could represent a significant prospective solvency risk to the company, the activity should be selected as key and walked through the seven-phase examination process. In all cases, the examiner should document the reasoning behind key activity selection in the examination planning memorandum.

E. Part 5: Consideration of Prospective Risks for Indications of Solvency Concerns

In addition to conducting an examination to verify the current status of the company's solvency condition, the risk assessment surveillance cycle requires examiners to prospectively consider the company's financial condition by assessing whether the company's current processes provide indications of future solvency concerns. In conducting examinations based on the risk-focused surveillance framework, the examiner should give consideration to the business

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processes and management controls that often are considered retrospectively after financial issues indicate that a company has potential financial solvency issues. In addition to assessing business risks, other elements that would commonly be assessed for prospective solvency risks include consideration of the company's asset/liability matching approach, process for establishing loss reserves, pricing and underwriting, and reinsurance arrangements. Among other things, these assessments should include consideration of the company's rate of growth and whether the liquidity of assets would create future concerns about the company's financial solvency.

This approach will allow the examiner to review risks that existed at the examination "as of" date and will be positioned to assess risks that extend or commence during the time the examination was conducted and risks that are anticipated to arise or extend past the point of examination completion. How the examiner addresses the prospective risk noted during the examination depends on the nature of the prospective risk itself.

By the end of Phase 1 of the examination, the examination team should have completed a high-level review of the insurer to identify any solvency concerns that commenced or extended after the examination date, or that are anticipated to commence or extend beyond the examination completion date. Such concerns may be identified through various aspects of the planning process, such as C-level interviews, review of Form F – Enterprise Risk Report, input from the analyst, review of the most recent Form 10-K, etc. If the examiner identifies a prospective risk that relates to one specific key activity of the company, this prospective risk should be documented in the corresponding risk matrix (or similar documentation) for that key activity and should be treated the same as all other identified risks. As such, examples of risks that an examiner may want to consider in assessing prospective solvency concerns related to common key activities have been included within the examination repositories. However, if the examiner identifies an overarching prospective risk (a prospective risk that does not relate to a specific key activity identified, or relates to more than one key activity identified), the examiner should utilize Exhibit V – Overarching Prospective Risk Assessment to document the process to consider these prospective risks.

By the end of Phase 1, the examiner should have a preliminary listing of overarching prospective risks included on Exhibit V. Prospective risks may continue to be identified beyond Phase 1. Any significant overarching prospective risks identified during later phases of the exam should continue to be documented and investigated on Exhibit V, regardless of the phase in which the risk was identified. For additional guidance on identifying and investigating overarching prospective risks during the examination, see the instructions on Exhibit V – Overarching Prospective Risk Assessment.

The examiner should complete Exhibit CC – Issue/Risk Tracking Template or a similar document to show how significant solvency risks have been identified and accumulated through the planning process. Significant issues/risks on Exhibit CC should be considered for further evaluation during the examination, either through Exhibit V, a key activity matrix or the examination planning memo.

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PHASE 2 – IDENTIFY AND ASSESS INHERENT RISK IN ACTIVITIES

At the end of Phase 1, the key activities requiring examination have been determined as part of the planning process. These are outlined as follows:

A. Identifying the Risk
B. Identifying the Type of Risk
C. Assessing the Inherent Risk
D. Reviewing Inherent Risks and Finalizing Examination Planning

A. Identifying the Risk

Risks Other Than Financial Reporting
In Phase 1, key functional activities were identified and captured in the Risk Assessment Matrix (or similar documentation). Phase 2 requires the examiner to identify specific risks of the key activities captured related to business and prospective risks. The examiner should consider potential events that, if they occur, may affect the entity when determining risks. As stated in Phase 1, these risks would be included on the Risk Assessment Matrix (or similar documentation). These risks may require that detailed examination procedures are performed or that the risks be communicated to the financial analysts for ongoing monitoring and use in the supervisory plan. The examiner may identify risks through various means, such as leveraging off of the insurer's own risk assessment, interviewing management and utilizing any other source that may assist in identifying risk. Exhibit CC – Issue/Risk Tracking Template or a similar document should be completed to show how issues noted in Phase 1 were incorporated into the process to accumulate and identify risks. The reference materials discussed in Phase 1 can also be helpful to the examiner in identifying other than financial reporting risks. The Risk Assessment Matrix (or similar documentation), however, will be the central location for the documentation of risk assessment and conclusions related to these risks.

Financial Reporting Risks
In Phase 1, key functional activities were identified and captured in the Risk Assessment Matrix (or similar documentation). Phase 2 requires the examiner to identify risks of the key activities that are related to financial reporting and determine what the specific inherent risk is. To identify the components of risk for each key activity, the examiner may rephrase examination assertions or financial statement assertions into risk statements for the related activity. For example, within the key activity of investments, one of the relevant financial statement assertions is valuation. This methodology suggests turning that assertion into a risk statement; e.g., the value of investments is overstated in the financial statements. The ensuing inherent risk assessment will be conducted based on this risk statement (i.e., what is the likelihood and impact of securities being overstated). This is what makes the process risk-driven or risk-focused. Rephrasing examination assertions into risk statements is only the starting point in identifying risk. The examiner may identify risks through various means such as leveraging off of the insurer's own risk assessment; utilizing internal and external audit's risk assessment; utilizing filing requirements of the SEC and SOX (Sections 302 and 404); reviewing 10-K filings; performing interviews with management; reviewing results of preliminary analytical review procedures; and using any other source that may assist in identifying risk. Exhibit CC – Issue/Risk Tracking Template or a similar document should be completed to show how issues noted in Phase 1 were incorporated into the process to accumulate and identify risks. The risk statement (identification of the risks for each of the key activities) is listed in the Risk Assessment Matrix (or similar documentation).

B. Identifying the Type of Risk

Risks Other Than Financial Reporting and Financial Reporting Risks
After the examiner populates the Risk Assessment Matrix (or similar documentation) with identified risks, the examiner must assign a risk classification to each identified risk. At least one of the nine risk classifications are to be identified in the Risk Assessment Matrix (or similar documentation) for each specific risk identified. Note that more than one of the nine risk types may be applicable to a particular identified risk; and, as such, more than one risk type may be listed in the branded risk column of the Risk Assessment Matrix (or similar documentation). However, it is not necessary to identify the level of inherent risk for each of the nine classifications. The process is driven by the risk identified in the risk

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statement of the activity and the controls used to mitigate that risk. The risk classifications allow for a summary of the major types of risks in the activities. Each inherent risk identified should be associated with at least one of the following risk classifications:

1. Credit – Amounts actually collected or collectibles are less than those contractually due or payments are not remitted on a timely basis.

2. Legal – Non-conformance with laws, rules, regulations, prescribed practices or ethical standards in any jurisdiction in which the entity operates will result in a disruption in business and financial loss.

3. Liquidity – Inability to meet contractual obligations as they become due because of an inability to liquidate assets or obtain adequate funding without incurring unacceptable losses.

4. Market – Movement in market rates or prices, such as interest rates, foreign exchange rates, or equity prices adversely affect the reported and/or market value of investments.

5. Operational – The risk of financial loss resulting from inadequate or failed internal processes, personnel and systems, as well as unforeseen external events.

6. Pricing/underwriting – Pricing and underwriting practices are inadequate to provide for risks assumed.

7. Reputation – Negative publicity, whether true or not, causes a decline in the customer base, costly litigation, and/or revenue reductions.

8. Reserving – Actual losses or other contractual payments reflected in reported reserves or other liabilities will be greater than estimated.

9. Strategic – Inability to implement appropriate business plans, to make decisions, to allocate resources or to adapt to changes in the business environment will adversely affect competitive position and financial condition.

See Exhibit L for guidance that relates the above risk classifications to risk areas that correlate to an insurer's key activities and financial statement areas. This guidance will assist the examiner to determine the level of inherent risk. See Section 3 – Examination Repositories for examples of risks that fit into one of the nine branded risk classifications. The branded risk classifications should also be assigned to each prospective risk identified on Exhibit V – Overarching Prospective Risk Assessment and will assist in communications with the financial analyst.

In addition to the branded risk classifications, examiners should consider examination assertions for financial reporting risks. Similar to the branded risk classifications, examination assertions will help examiners to determine whether each category of assertions is adequately addressed by an inherent risk. The following examination assertions should be considered:

Examination Assertions

The examination assertion for *Accuracy* (AC) verifies whether recorded transactions and account balances are mathematically accurate, are based on correct amounts and have been classified into the correct account. This assertion would often be applicable to noted operational risks and is particularly relevant for both liability and asset accounts. (The determination of the accuracy of account items is specifically considered in accordance with the accreditation process.) Examples of procedures to verify the accuracy of accounts include completing reconciliations, tracing account information to supporting documents and the general ledger, and determining whether the guidelines within the *Accounting Practices and Procedures Manual* for accounting or classifying specific transactions have been followed.

The examination assertion for *Completeness* (CO) verifies whether all transactions and account balances that should be recorded in the annual financial statement were recorded. This assertion would often be applicable to noted reserving and operational risks and is particularly relevant for liability accounts (Completeness testing is specifically considered in

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accordance with the accreditation process as a common examination concern pertains to whether the company has understated their liabilities). Example procedures to verify the completeness of accounts include performing a search for unrecorded liabilities (searching for liabilities paid in subsequent periods that were due but not recorded at the date of the financial statements) and reviewing contract terms to ensure all liabilities have been considered.

The examination assertion for *Compliance* (CM) verifies whether business transactions and affairs have been conducted in accordance with state insurance codes, other state laws, or department directives. This assertion would often be applicable to noted operational, legal, and reserving risks. This assertion provides verification that the company is adhering to the accounting practices of the *Accounting Practices and Procedures Manual* as well as state prescribed practices. Example procedures to verify compliance include confirming accounting methodologies to the respective guidance.

The examination assertion for *Cutoff* (CT) verifies whether transactions are recorded in the correct accounting period. This assertion would often be applicable to noted operational risks. This assertion is essential for both asset and liability accounts as the inappropriate inclusion of assets or the exclusion of liabilities within the financial statements may cause the financial statements to be misstated. A standard procedure to verify cutoff involves tracing year-end transactions to supporting documentation to verify reporting within the proper period. Although pertinent to several accounts, the areas most likely to be impacted are cash (cash received immediately after year-end may be used to increase the year-end balance) and claims (year-end claims may be excluded to reduce year-end liabilities) to improve the overall solvency appearance.

The examination assertion of *Existence* (EX) verifies whether recorded transactions occurred and are not fictitious and recorded assets and liabilities existed as of the balance sheet date. This assertion would often be applicable to noted credit and operational risks. Although potentially a concern for liability accounts, this assertion is primarily related to the overstatement of asset accounts. Examples of procedures to verify existence include obtaining confirmations on receivable balances, performing subsequent receipt testwork (verifying the collection of receivable balances posted as of year-end), reviewing contract details (reinsurance), and ensuring the collectibility of accounts is assessed and necessary write-offs have been completed in accordance with the *Accounting Practices and Procedures Manual* and state-prescribed practices.

The examination assertion of *Obligation and Ownership* (OB/OW) verifies whether recorded liabilities are obligations of the company and recorded assets are the rights of the company at the balance sheet date. This assertion would often be applicable to noted reserving or operational risks. This assertion often pertains to whether premiums received in advance (or other such accounts) are appropriately established as liabilities and whether reinsurance credits are properly reflected.

The examination assertion of *Valuation* (VA) verifies whether assets and liabilities are valued in accordance with state statute and NAIC accounting guidance. This assertion would often be applicable to noted operational, market, and reserving risks. This assertion pertains to the specific calculation or assessment of value determined for items within an account. Examiners can verify the valuation of accounts by comparing the calculation or assessment of account items to guidelines within the *Accounting Practices and Procedures Manual* or to state-prescribed guidelines.

The examination assertion of *Presentation and Disclosure* (PD) verifies whether the elements of the annual statement are properly classified and all disclosures are accurately included in the annual statement. This assertion would often be applicable to noted operational or reputation risks. Examiners can verify compliance with this assertion by reviewing the disclosures provided within the financial statements and comparing this information to the NAIC or state requirements.

C. Assessing the Inherent Risk

Risks Other Than Financial Reporting and Financial Reporting Risks

The assessment of inherent risk can be accomplished by consideration of the likelihood of occurrence and magnitude of impact along with professional judgment. Qualitative, as well as quantitative, factors are to be considered for each risk identified in arriving at the overall assessment.

The "likelihood of occurrence" is the probability the risk will occur or would prevent a process or activity from attaining its objectives. Likelihood of occurrence is intended to capture the likelihood of misstatement or process failure. Using the risk statement from the example above, the examiner would consider the likelihood that securities are overstated when assessing inherent risk. Likelihood of occurrence is measured as:

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High	The risk event is expected to occur most of the time.
Moderate-High	The risk event will probably occur at some time.
Moderate-Low	The risk event could occur at some time.
Low	The risk event may only occur in rare occasions.

Factors to consider when assessing the likelihood of occurrence include, but are not limited to:

- Frequency of the risk factors – How often are the processes and transactions happening?

  Examiners should consider that some processes and functions that happen frequently provide more opportunities for errors to occur, but they should also consider that redundant processes may carry less risk based upon the high frequency. Professional judgment should be used to evaluate the risks surrounding frequency.

- Transaction type – Is it a manual or automated transaction?

  Examiners should consider that manual transactions may be more risky based upon the opportunity for manipulation or simply based upon human involvement/error. However, examiners should consider the effectiveness of the overall IT environment at the insurer, as if there is an error in the programming for the automated transaction, then there is the potential for all transactions to be consistently inaccurate.

- Past experience with company – How often have there been errors in the processes and transactions in previous years?

  Examiners should consider the frequency with which errors have been encountered on previous examinations and audits. Only the frequency should be considered for likelihood, as the financial extent of those errors will be considered within the magnitude of impact. If the examiner is not familiar with the past history of the company in a certain area, it may be appropriate to consider past experience with other similar companies or the overall industry.

- Staff competency/experience – Does the insurer employ a sufficient number of qualified staff to process the transactions?

  Examiners should consider the qualifications of existing company personnel to perform the necessary procedures to mitigate the risk. Additionally, examiners should consider whether the insurer generally has an appropriate number of employees to adequately handle the workload.

- Complexity of transactions – Do the transactions require complex calculations or allow for significant estimates?

  Examiners should consider the complexity of calculations and the likelihood that errors, whether from incorrect formulas or human miscalculation, may occur. Examiners should also consider the extent of judgment involved with the transaction and allowed by statutory accounting principles and the company's policies and procedures.

- Susceptibility to fraud – Do the transactions or processes lend themselves to misappropriation or improper financial reporting?

  Examiners should consider the ease with which the transactions or processes could be modified or falsified. Additionally, examiners should consider how often these opportunities arise.

- Current business environment – How often do external and internal environmental factors lead to the possibility of errors?

  Examiners should consider how often environmental factors may lead to errors. External environmental factors could include things such as legal or regulatory changes, market fluctuations or changes in product demand.

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Internal environmental factors could include things such as high turnover in critical personnel, modifications to existing or new information systems or mergers and acquisitions.

The "magnitude of impact" is the potential impact or potential materiality effect of a risk. The impact is largely the dollar impact in terms of surplus. Magnitude of impact is intended to capture materiality when assessing inherent risk. The materiality levels set during the planning phase should be used to assess the magnitude of impact. Magnitude of impact is assessed as:

Threatening

> 5% of surplus
Serious financial solvency concerns
Material rating agency downgrade

Severe

3% to 5% of surplus
Serious impact on reputation and shareholder value with adverse publicity
Events and problems will require board and senior management attention

Moderate

1% to 3% of surplus
Shareholder value and/or reputation will be affected in the short term
The event will require senior and middle management attention

Immaterial

< 1% of surplus
No potential impact on shareholder value
No impact on reputation
Issues would be delegated to junior management and staff to resolve

Factors to consider when assessing the magnitude of impact include, but are not limited to:

- Transaction volume – What is the frequency and size of transactions?

  Examiners should consider how often transactions are occurring and the magnitude of an error that could occur based upon that frequency. Examiners should be mindful that frequent small transactions that are consistently being conducted improperly could lead to an error of significant impact. Conversely, one error in a single infrequent large transaction could also be of significant impact to the insurer.

- Solvency impact – Does the risk pose a threat to the future solvency of the insurer?

  Examiners should consider the solvency impact that errors may cause for the insurer. Considerations should include whether the error, though large, only affects the current financial statements or whether the error could pose a continued threat to the company (e.g. inadequate reserves). Additional risks to be considered may include potential for ratings downgrades. In addition to quantifiable financial errors, examiners need to be cognizant to consider the non-financial solvency threats that could lead to a ratings downgrade (e.g. product exposures, interest rate exposure, investment concentrations, etc).

- Past experience with company – What has the effect of errors been in previous years?

  Examiners should consider the extent of errors previously encountered in past examinations and audits. This evaluation may include an accumulation of errors related to the risk identified to appropriately gauge the true magnitude of impact. If the examiner is not familiar with the past history of the company in a certain area, it may be appropriate to consider past experience with other similar companies or the overall industry.

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- Reputational damage – Could the effects of the risk impact the reputation of the insurer or its affiliates?

  Examiners should consider the effect of reputational damage that may arise due to an error or lack of controls for the risk identified and the extent to which it may affect the insurer. Examiners should also consider the reputational risks the insurer faces based upon the actions of its affiliates with regard to the risk identified.

- Risk/Event action level – What extent of involvement would be necessary to address the issue?

  Examiners should consider whether the effects of an error or control issue could be handled at a functional level, senior management level or if it would require board involvement. Additional considerations may be necessary as to the extent of regulatory involvement necessary to resolve the issue.

The "overall inherent risk assessment" is determined by taking into account the likelihood of occurrence, the magnitude of impact and the examiner's professional judgment. Overall inherent risk may be assessed as high, moderate or low. This assessment is placed in the Risk Assessment Matrix and the Overall Inherent Risk Rating Scale shown below provides guidance to assist in assessing inherent risk.

Overall Inherent Risk Rating Scale

Likelihood of Occurrence	Magnitude of Impact: Threatening	Severe	Moderate	Immaterial
High	High	High	High	Moderate
Moderate-High	High	High	Moderate	Moderate
Moderate-Low	High	Moderate	Moderate	Low
Low	Moderate	Moderate	Low	Low

The definitions for these rankings are as follows:

1. High Inherent Risk – The business activity is significant and/or transactions are large in relation to the company's financial strength. The number of transactions and/or the complexity/volatility of the business activity (particularly underwriting risks) appears higher than normally encountered or requires competent management expertise. In this context, the business activity potentially could result in a significant and harmful loss to the organization.

2. Moderate Inherent Risk – The business activity is significant, but transactions are moderate in size in relation to the company's financial strength. The number of transactions and/or the complexity/volatility of the business activity (particularly underwriting risks) are considered more easily manageable. Thus, the business activity could result in a loss to the insurer, but the loss could be absorbed in the normal course of the business.

3. Low Inherent Risk – The nature, transaction volume, size, volatility and/or complexity of a business is such that a loss would either be remote or have an insignificant negative impact on the insurer's financial strength.

Once the overall inherent risk assessment has been determined, the examiner should reevaluate whether all risks assessed as low should remain on the Risk Assessment Matrix and proceed through the risk-focused process. For example, a risk with a low likelihood of occurrence and an immaterial magnitude of impact may not be a significant risk to the company; therefore, it may be appropriate for the examiner to remove the risk from the risk matrix before proceeding to Phase 3. This will allow the examiner to focus exam resources on the more significant risks of the company.

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D. Reviewing Inherent Risks and Finalizing Examination Planning

After inherent risks have been identified and assessed for each key activity, the risks selected should be reviewed for adequacy and completeness. One of the goals of a risk-focused examination is to focus on the most critical solvency risks facing an insurer. To assist the examination team in meeting this goal, a list of critical risk categories has been developed for consideration in reviewing the adequacy of risk statements developed for review on each examination. This list of critical risk categories and the corresponding documentation template (see Exhibit DD – Critical Risk Categories) should be utilized to demonstrate that all critical risks facing the insurer have been selected for review. To the extent that an individual critical risk category is not deemed relevant for review, rationale for this decision should be provided within the exam planning memorandum.

Proper risk analysis and planning of an examination are essential to the development of an effective examination plan. A thorough understanding of the company's businesses and of the effects of significant changes, trends, and current events is critical to properly planning an examination. At the conclusion of Phase 2, the examiner should document results of the planning process through the completion of an exam planning memorandum. See Exhibit I – Examination Planning Memorandum for additional guidance regarding the topics that should be included in this memo. Planning documentation including the planning memo should be reviewed and approved by both the chief examiner (or designee) and the examiner-in-charge prior to the performance of control (Phase 3) testwork.

If it is determined that certain detail procedures will be necessary for an identified risk, regardless of the risk mitigation strategies/controls that may or may not be in place, the examiner should consider completing the residual risk assessment for the particular identified risk in order to begin testing expeditiously. Generally, these would be risks that are material and have a high inherent risk which may require time-consuming procedures to be performed, regardless of the controls that may be in place. In order to accomplish this, the examiner should document the rationale for such decision in the exam planning memorandum. Approval of the memo should be received from the chief examiner, or designee, prior to detail testwork. At the same time, as the examination procedures are being performed, risk mitigation strategies/controls may still continue to be evaluated in order to determine the final residual risk assessment and the additional examination procedures that may need to be performed.

In Phase 3, the examination team will identify and evaluate the risk management strategies and controls related to these inherent risks.

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PHASE 3 – IDENTIFY AND EVALUATE RISK MITIGATION STRATEGIES (CONTROLS)

This section of the Handbook addresses the following subjects:

A. Identifying Risk Mitigation Strategies/Controls
B. Evaluating Risk Mitigation Strategies/Controls
C. Consideration of Small/Medium-Sized Insurers
D. Examiner Use of Sarbanes-Oxley Documentation

Phase 3 requires the identification and evaluation of the insurer's risk mitigation strategies/controls that are in place to mitigate the inherent risks identified in Phase 2. First, examiners should focus on identifying and understanding internal controls that the insurer has in place. Second, examiners should consider whether the controls in place appear to be designed appropriately to mitigate risk. Third, if the examiner determines that the controls appear to be designed appropriately and may be mitigating the inherent risk, then the examiner should test the controls for operating effectiveness, if the testing of controls will provide exam efficiencies. After testing the operating effectiveness of the identified controls, the examiner should conclude whether the internal controls effectively mitigate the inherent risk.

Risk mitigation strategies/controls are generally based on five overarching principles, which are applicable to all key activities:

1. An active board and senior management oversight.
2. Adequate risk management, monitoring and management information systems.
3. Adequate and clear policies, authorization limits and procedures.
4. Comprehensive internal controls.
5. Processes to ensure compliance with applicable laws and regulations.

The first two principles are evaluated as part of Phase 1, while the examiner is gaining an understanding of the insurer's operations and corporate governance. Various insurers are required to comply with the NAIC *Annual Financial Reporting Model Regulation* (#205), the federal Sarbanes-Oxley Act of 2002 and various other corporate governance standards that require a certain amount of board oversight and risk management. Examiners should realize the pervasive effects of these two principles when evaluating specific controls over each of the identified risks during Phase 3. The examiner should also consider what impact, if any, corporate governance may have with regard to controls or risk mitigation strategies. Thus, if the insurer demonstrates strength in the first two principles, then the examiner should consider how these strengths might help offset weaknesses in specific controls. Conversely, if the insurer demonstrates weakness in the first two principles, then the examiner should consider how these weaknesses might reduce or negate the effectiveness of specific controls. For example, management's ability to override or circumvent controls could impact the examiner's evaluation of the insurer's risk mitigation strategies and controls.

The final three principles of risk mitigation strategies/controls are to be evaluated throughout the completion of Phase 3. For each of the specific risks identified in Phase 2, the examiner will be able to identify and assess internal controls by reviewing the insurer's policies and procedures, specific internal controls and processes to ensure compliance.

One approach to identifying and assessing internal controls involves the comparison of controls to a generally accepted standard. The most commonly accepted standards relating to internal controls are the Committee of Sponsoring Organization's (COSO) Integrated Framework of Internal Control and the IT Governance Institute's Control Objectives for Information and Related Technology (COBIT). As these standards are widely accepted by many companies, it may be useful for examiners to become familiar with the concepts included in the COSO Integrated Framework of Internal Control and the COSO Enterprise Risk Management Integrated Framework, as well as other COBIT tools, to utilize as sources when identifying and assessing an insurer's risk mitigation strategies/controls. Although companies are not

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required to utilize the COSO or COBIT standards, the key components within these standards are likely to be incorporated within any framework the company may utilize.

A. Identifying Risk Mitigation Strategies/Controls

The insurer's internal controls can be identified using a number of sources including company control documentation and documentation from external and/or internal auditors. This documentation could include narrative descriptions, checklists, flowcharts, Sarbanes-Oxley compliance documentation and/or other source information. In the rare situations where no documentation is available from the company or external auditors, the examiner should document the understanding of internal controls related to each identified risk within a key-activity. This documentation need not be extensive but should, at a minimum, allow the examiner to identify and assess key controls and provide the examiner with adequate information to develop an effective examination approach.

Examiners may also utilize walkthroughs of key processes to further their understanding of the existing controls the company has in place. Walkthroughs are important for (1) providing an understanding of the process flow of transactions; (2) evaluating the design of controls; (3) considering the completeness of the process; and (4) determining whether controls have been implemented.

Additionally, depending on the risks identified, it may be beneficial for the examiner to consult with the IT specialist to determine whether application controls are in place and should be tested to address the risks identified. In some instances, it may be more efficient and effective to review application controls that rely on other manual internal controls surrounding the process. Examiners should also carefully consider the results of the IT general controls review, as there may be findings that could impact the examiner's approach to application control testing.

When identifying controls, the examiner should consider that although a control or multiple controls exist in a particular area, they may not be designed effectively to mitigate the specific identified risk being evaluated by the examiner. Therefore, the examiner should understand and assess the design of each internal control identified. For financial reporting risks, controls are typically designed in such a way that one or more exam assertions are addressed.

During the review of the design of controls, the examiner should take into consideration the type of control and how well it appears to mitigate the inherent risk. Although it is not required, it may be helpful for the examiner to classify controls. Controls can be classified as either preventive or detective. Preventive controls are designed to prevent the risk from occurring. An example of a preventive control would be an automated payment system that will not release payment unless authorized by two separate employees. Preventive controls generally are stronger than detective controls and this should be taken into consideration when assessing controls. Detective controls are designed to detect the anomaly after it has already occurred. An example of a detective control would be a reconciliation. Most reconciliations are performed after a transaction has taken place and will detect a problem after it has occurred. Detective controls are generally weaker than preventive controls. It is likely that the examiner may find a combination of both preventive and detective controls in an organization. While preventive controls are generally considered stronger, the examiner should consider the risk the control is designed to mitigate and the appropriateness and/or feasibility of the type of control in place.

Controls can be further classified as either specific or monitoring. Specific controls are the performance of a specific process, such as reconciling sub-ledgers to the general ledger. Specific controls generally are stronger than monitoring controls, and this should be taken into consideration when assessing controls. Monitoring controls review the process by a supervisor. Monitoring controls generally are weaker than specific controls, and this should be taken into consideration when assessing controls.

Following the consideration of control design, examiners should document their understanding of the insurer's internal controls within the examination workpapers, taking into consideration that more than one control could address an identified risk. Exhibit L – Branded Risk Classifications provides guidance relating to controls and their associated risk areas, which correlate to branded risk classifications. This exhibit can be used to consider the need and importance of controls for financial reporting risks and risks other than financial reporting.

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B. Evaluating Risk Mitigation Strategies/Controls

Once the risk mitigation strategies/controls have been identified and the design assessed, the examiner should test these areas, if the examiner intends to place some reliance on controls. Testing will assist the examiner in determining whether the designed controls are operating effectively to mitigate the inherent risk. The results of the control testing will impact the examiner's assessment of the internal controls, which ultimately will affect the residual risk in Phase 4 and the examination procedures planned and executed in Phase 5. As illustrated within the discussion of small/medium-sized insurers, as noted in Section C of this document, examiners should not proceed with testing controls if the controls will not be utilized to impact residual risk assessments. Continuous assessment of controls is necessary for the overall risk assessment process. Controls that are initially assessed as strong, based on management's description of controls, may be reassessed as weak as a result of control testing conducted. A change in the assessment of controls will affect the residual risk and, thus, the overall risk assessment process.

As previously noted, an examiner may use walkthroughs to gain an understanding of internal controls in place at the insurer. These walkthroughs can be used as a component of control testing; however, a walkthrough alone is not sufficient to come to a conclusion on the strength of internal controls and should be paired with additional testing to evaluate the operating effectiveness of controls.

Some other examples of control testing procedures (listed from the least amount of examination evidence to the most) include:

- Inquiry – Inquire of company personnel performing/monitoring the control on how the control works. Inquiry is complementary to other procedures performed and may not be sufficient to conclude upon the operating effectiveness of controls.

- Observation – Observe the control being performed by company personnel. Observation differs from examination of documents, in that it is used to gather evidence regarding controls that leave no audit trail. For example, an examiner may observe a specific clerk deposit cash daily. Observation only provides evidence about the performance of a specific activity at a specific point in time. Individuals may alter their behavior if it is known that the observation is taking place.

- Re-performance – Re-perform the same control as the company personnel to verify that the control is being performed as expected.

- Examination of documents – Inspect documents or records to substantiate the information that is, or should be, included in the financial statements. Examination differs from observation, as it is the review of underlying support for controls that leave an audit trail.

Risks Other Than Financial Reporting

Other-than-financial reporting risks are often associated with a qualitative aspect of a company, such as the adequacy of certain strategies or contractual duties used to carry out the company's operations or the possibility of some future event. As implied by the name, these types of risks may not have a direct financial impact to the company at the time of the examination; however, if management is not properly monitoring the risk, it could lead to a deficiency at some point in the future. Due to the nature of this type of risk, and the fact that a company may only have a strategy in place to monitor the risk—rather than a systematic, periodic measurement of the risk—the examiner's evaluation of the risk may require a greater emphasis on the testing of mitigation strategies in place. Because testing risk mitigation strategies/controls over risks other than financial reporting may provide the greatest evidence that a risk is ultimately mitigated, the examiner should consider:

1. The extent to which an insurer is able to manage all the risks inherent in its significant business activities and other major activities and, in particular, its ability to identify, assess and manage these risks.

2. The adequacy of the qualitative and quantitative assumptions implicit in the risk management process.

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3. Whether risk policies, guidelines and limits at the insurer are appropriate and consistent with its significant business activities, management experience level and overall financial strength.

4. Whether the management information system and other forms of communication are consistent with the level of business activity and the complexity of products offered at the insurer, and whether such systems provide sufficient support to accurately monitor risk exposure and compliance with established limits.

5. The ability of management to recognize and accommodate new risks that may arise from the changing environment and to identify and address risks not readily quantified in a risk management process.

Additionally, with many other than financial reporting risks, the timing of the risk mitigation strategy may affect the nature of testing performed. When testing financial reporting risks, it is typically expected that the risk mitigation strategy be tested at the "as-of" date; however, for many other-than-financial reporting risks, it may be more appropriate to test the current practice. For example, it may be more appropriate to review a company's current investment strategy in order to determine its long-term adequacy, rather than the investment strategy in place at the "as-of" date. Further, there are circumstances when reviewing both time periods may be beneficial. Using the example above, it may be appropriate to review the investment strategy in place at the "as-of" date to gain assurance of the appropriateness of the strategy and its effect on the balance sheet at the "as-of" date, as well as the current investment strategy.

Results of the testing should be documented in the Risk Assessment Matrix (or similar documentation) and should assist the examiner in determining an overall risk rating.

Financial Reporting Risks
Factors that should be considered during the testing of controls over financial reporting risk include whether the controls are (1) operating as expected; (2) being applied consistently throughout the entire period of reliance; (3) being performed on a timely basis; (4) encompassing all transactions; and (5) identifying errors.

Consideration should be given to work performed by external auditors to minimize work performed by the examiner. If external audit workpapers are utilized, testing may also be performed by the examiner to further substantiate whether controls are adequate and operating effectively. This can be achieved by retesting the work performed by the external auditors, performing original testing, or a combination thereof. There is no retesting requirement of auditors' workpapers and the extent of any retesting performed should be based on the amount of reliance the examiner is placing on the auditors' workpapers. Examiners should refer to the Examination Sampling guidance located in Section 1 of this Handbook for assistance with determining sample sizes.

Reliance on Control Testing Performed in Prior Years

An examiner may be able to rely on control testing performed in a prior period, whether that testing is documented in internal or external audit workpapers. Some auditors perform control testing on a cyclical basis and, as a result, the same controls are not always tested every year. In addition, internal audit work is often performed on a rotational basis and key activity controls may not be tested every year.

If an examiner plans to utilize control testing documentation from a year prior to the current examination as-of date, the examiner should obtain evidence that the control has not changed subsequent to the prior period testing. The more reliance that is placed on the prior period testing documentation received from external/internal auditors, the more examination evidence should be obtained. Verification that controls have not changed should be obtained by a combination of inquiry, observation, reperformance and examination of documents, and should be clearly documented in the examination workpapers. If controls have significantly changed since the prior period, the examiner should not utilize the prior period workpapers for that area as examination evidence.

Risk Mitigation Strategies/Controls Ratings – Once the examiner has completed the testing of internal controls, the examiner should determine an overall risk mitigation strategy/control rating. Regardless of the number of controls that exist for an inherent risk, only one overall rating should be assigned. The Risk Mitigation Strategy/Control Assessment ratings to be indicated in the Risk Assessment Matrix (or similar documentation) for other than financial reporting risks

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and financial reporting risks are:

- **Strong Risk Management** indicates that management effectively identifies and controls all material types of risk posed by the relevant activity. Management participates in managing the insurer's risks and ensures that appropriate policies and limits exist. The board of directors understands and reviews the policies and limits and requires that significant exceptions are reported by management to the board. Policies and limits are supported by risk monitoring procedures, reports and management information systems that provide accurate, timely and necessary information and analyses to make timely and appropriate decisions to changing conditions. Internal controls and audit processes and procedures are appropriate to the size and activities of the insurer. There are few exceptions to established policies and procedures, and none of these exceptions would likely lead to a material loss to the company. For financial reporting risks, this could be evidenced, in part, by few or no control deficiencies (see definitions in Phase 4).

- **Moderate Risk Management** indicates that the insurer's risk management processes, although largely effective, might be lacking to some modest degree. It reflects an ability to cope successfully with existing and foreseeable exposures that may arise in carrying out the insurer's business plan. Although the insurer may have some minor risk management weaknesses, these problems have been recognized and are being addressed. Overall, board oversight, management policies and limits, risk monitoring procedures, reports and management information systems are considered effective in maintaining a safe and sound managed company where the potential for economic loss does not appear significant. Risks are generally being controlled in a manner that does not require above-normal supervisory monitoring. For financial reporting risks, this could be evidenced, in part, by the existence of control deficiencies that are not considered to be significant or material weaknesses (see definitions in Phase 4).

- **Weak Risk Management** indicates risk management processes that are lacking in important ways and, therefore, are a cause for above-normal supervisory attention. Ineffective participation in the oversight, establishment of pertinent policies and the provision of appropriate direction (and evaluation of performance) is lacking from senior management. The internal control system may be lacking in important respects, particularly as indicated by continued control exceptions or by the failure to adhere to written policies and procedures. The deficiencies associated in these systems could have a significant adverse impact on the potential for economic loss; the reputation of the insurer in the marketplace; or could lead to a material misstatement of its financial statements if corrective actions are not taken promptly by management. For financial reporting risks, this could be evidenced, in part, by the existence of significant control deficiencies and/or material weaknesses (see definitions in Phase 4).

In the event that an examiner has difficulty choosing between two ratings, the examiner may consider the strength of an insurer's overall corporate governance to help reach a decision. For example, if an examiner is wavering between moderate and strong control rating after considering the nature of the controls in place and the evidence obtained through testing, an effective overall corporate governance environment should encourage the examiner to assess the rating as strong. Conversely, if the corporate governance at the insurer is in many ways ineffective, the examiner may choose to assess the rating as moderate. However, corporate governance practices cannot fully mitigate an individual risk unless they are directly related. If an examiner chooses to utilize overall corporate governance considerations to assist with the assessment of risk management, then he or she must document the rationale for that decision within the risk assessment matrix. This documentation may contain references to specific items identified during the assessment of corporate governance completed as part of Phase 1.

C. Consideration of Small/Medium-Sized Insurers

For many small-to-medium sized insurers, appropriate segregation of duties to mitigate identified inherent risks may not exist. This generally is due to the costs associated with employing a sufficient number of employees. Therefore, a small or medium-sized company might achieve its control objectives in a different manner than a large insurer. For example, a small or medium-sized entity may place more reliance on its control environment and monitoring procedures than specific control activities.

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The extent of internal control documentation included in the workpapers is influenced by the nature, size, and complexity of the entity and its environment. There are many levels of documentation that may exist for an insurer's controls. For public companies there is typically extensive SOX documentation available. For large, non-public insurers, controls may be documented through management's assessment of internal controls as required by the NAIC *Annual Financial Reporting Model Regulation* (#205), commonly referred to as the Model Audit Rule (MAR). For those insurers who are not required to fully comply with SOX or MAR, an annual financial statement audit would still be required. Under the Statements of Auditing Standards (SAS), required by the American Institute of Certified Public Accountants (AICPA), controls must be documented and reviewed by the external auditor during the financial statement audit. If the insurer does not fall under any of the above situations, they may still have internal controls documented by company personnel, internal auditors or others.

Although extensive documentation of insurer controls makes an exam more effective and efficient, unwritten policies and procedures may still be effective if they have been adequately communicated and implemented. Whether or not policies and procedures are written, they must be implemented thoughtfully, conscientiously, and consistently in order to be effective. Controls that are not documented may be tested in a similar manner as if the controls were documented. Examiners should not automatically default to performing only detail testing when documentation is not available. Regardless of the documentation available, the examiner should determine whether controls are in place and mitigating the identified risks. Examiners may still realize examination efficiencies through control testing even in situations where no, or limited, documentation is available. All of the aforementioned sources of documentation may be useful to examiners in documenting their understanding of controls; however, in situations where control information is not documented or readily available, examiners should not create documentation of the controls themselves, but rather, document their understanding of controls. This understanding may consist of only a few simple sentences describing how the company mitigates each identified risk.

If, after prudent inquiry, the examiner is unable to ascertain what controls exist at an identified risk level, the examiner should provide a brief narrative describing the general controls that exist for each key activity. Under these circumstances, control testing would not be required, because obtaining sufficient evidence of risk mitigation would not be likely to reduce the inherent risk(s). As such, an overall control rating of "weak" should be assigned to the identified risk(s). The examiner would then include a reference to documentation that would support this assessment. The examiner should follow up and report on any key controls noted during the examination that are determined to be deficient. When appropriate, comments should be included in the examination report, Insurer Profile Summary, supervisory plan and management letter for follow-up by the financial analysts and examiners.

After documenting an understanding of controls, there may be situations in which examiners determine that it would not be cost-effective or efficient to perform control testing. For these situations, the examiner may eliminate control testing and assess an overall control rating of "weak" for the identified risk(s). Although the risk-focused approach provides examiners with the flexibility to make this determination, the examiner should still focus examination efforts on those areas perceived to have a higher degree of risk and the examiner should attempt to test controls for those areas that are perceived to have a higher degree of risk.

D. Examiner Use of Sarbanes-Oxley Documentation

The Public Company Accounting Oversight Board (PCAOB) is a private-sector, non-profit corporation, created by the federal Sarbanes-Oxley Act of 2002 (SOX), to oversee the auditors of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, fair and independent audit reports. The overriding goal of the U.S. Congress and the PCAOB is the reliability of the company's financial statements. To achieve reliable financial statements, the PCAOB has indicated that internal controls must be in place for public companies to ensure that:

- Records are accurate and fairly reflect transactions in and dispositions of a company's assets.
- Records of transactions are sufficient to prepare financial statements in accordance with generally accepted accounting principles.
- Receipts and expenditures are made only as authorized by management and directors.

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- Steps are in place to prevent or detect theft, unauthorized use or disposition of the company's assets of a value that could have a material affect on the financial statement.

SOX requires management of public companies to make an assertion as to the adequacy of their financial reporting controls. As such, management is required to issue formal, risk-based assessments of the effectiveness of their financial reporting controls. In addition, the external auditor of public companies must attest and provide an opinion on the reliability of management's assertion of the adequacy of the financial reporting controls. Information available, either from public companies required to comply with SOX, or companies electing to voluntarily comply, as a result of these control testing activities related to the Act should be utilized in completing this section of the Risk Assessment Matrix (or similar documentation). Leveraging the significant SOX-driven financial reporting control assessment activities in companies should facilitate the similar risk assessment process for regulatory purposes.

The PCAOB adopted standards for auditors to use when assessing whether managers of a public company have accurately reported on the company's internal controls. These audit standards drive the work performed by the auditor, as well as the company, and benefit the examiner in their risk assessment of the company. Documentation should be included in the public company's external audit workpapers to support the requirements of SOX and the PCAOB. Examiners should plan to utilize this information and seek this documentation when reviewing external audit workpapers. The following section outlines the key areas of documentation that will be of assistance to the examiner.

Information to Be Obtained by the Examiner if the Company and External Auditor Has Complied with SOX (or similar) Documentation Requirements
The following list details the SOX-related items/information that should be identified and obtained from the company and/or the external audit workpapers by the examiner as part of the risk-focused examination.

- Listing of significant accounts and their relevant financial statement assertion(s).
- Listing of major classes of transactions and the significant processes within the major classes of transactions. The significant processes should correspond to specific significant account(s).
- Listing of the mitigating controls in place for each significant process.
- Documentation of the flow of transactions for each significant process. Understanding the flow of transactions typically takes the form of narratives, flowcharts and walkthroughs.
- Walkthrough documentation performed by auditor, which is required of the auditor at the major class of transaction level and may be performed at the significant process level.
- Control testing performed by the auditor.
- Auditor evaluation of the operating effectiveness of internal controls (at the significant process level).
- Overall assessment by the auditor of the operating effectiveness of internal controls over financial reporting.
- Any control deficiencies or material weaknesses identified by the auditor or company management (includes remediated and unremediated deficiencies).

Utilize SOX (Section 404) Reports for a Risk-Focused Examination
The depth and magnitude of SOX provides examiners with an enhanced ability to perform a risk assessment of an insurer in conjunction with the risk-focused surveillance process. The following information details how SOX Section 404 reports can be utilized by the examiner, if available, in accordance with the risk-focused examination approach. (The lack of SOX documentation should not preclude the examiner from completing a risk-focused examination. The availability of this information should only further expedite and expand the examiner's understanding of the company's activities, related risks and internal controls.)

Understand the Company and Identify Key Functional Activities
Phase 1 of the risk-focused examination process requires the examiner to identify key functional activities (i.e., business activities), along with their nature and level of risk, to ensure an appropriate exam scope. Along with an understanding of the company, corporate governance structure and the assessment of the audit function, the examiner should also consider the documentation as it relates to significant processes and major classes of transactions. Management of the company is responsible for identifying the significant processes and major classes of transactions, and the auditor is required to conclude on this aspect of management's assessment. The

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examiner should request a meeting with the company to obtain an understanding of the approach used by the company to comply with SOX Section 404. The examiner should consider the work performed by management and the auditor when determining the extent that an individual analysis of key functional activities is needed. In accordance with examiner judgment, reliance may be placed on the fact that management and the auditor have evaluated the company's significant processes and major classes of transactions.

2) **Phase 2 – Identify and Assess Inherent Risk in Key Activities**
Phase 2 requires the examiner to identify and assess inherent risk in activities. PCAOB Audit Standard No. 5 – *An Audit of Internal Control Over Financial Reporting That Is Integrated with An Audit of Financial Statements* suggests that the auditor begin with a top-down approach at the financial statement level with the auditor's understanding of the overall risks to internal control over financial reporting. This information should provide useful insight to the examiner in determining financial reporting risks of the company.

3) **Phase 3 – Identify and Evaluate the Insurer's Risk Management Systems (Controls)**
In accordance with the risk-focused examination approach, the risk mitigation strategies/controls should be assessed by determining how well the internal mitigation strategies/controls mitigate the inherent risks identified. It is in this phase of the examination that the examiner should benefit most from the SOX requirements. PCAOB Standard No. 5 requires the auditor to evaluate the design and operating effectiveness of internal controls. The auditor should test those controls that are important to the auditor's conclusion about whether the company's controls sufficiently address the assessed risk of misstatement to each relevant assertion. The examiner should be able to utilize the auditor's conclusions and supporting documentation to assist in understanding the important control processes at the company. In addition, the examiner may be able to utilize the testing of controls completed by the auditor upon appropriate evaluation of the auditor's work. Finally, the examiner will be able to quickly identify any deficiencies, noted by either the auditor or management, in internal control over financial reporting. The examiner can apply judgment to determine the appropriate areas on which to focus exam resources.

Request of Information and Additional Guidance
The external auditor's attestation of management's assessment of the effectiveness of internal control, also referred to as the audit of internal control of financial reporting, is performed in conjunction with the audit of the public company's financial statements. (These may also be available for some non-public companies who specifically request this external auditor attestation.) As a result, the request of this information should be made at the same time as the request for the financial statement audit workpapers. It would be helpful to have the SOX workpapers available at the time of the meeting with the external auditor, which is performed during the planning phase of the exam. As part of the SOX requirements, the company's management is required to assess and report on the company's internal control. The work that management performs in connection with their assessment significantly affects the nature, timing, and extent of the work that the auditor performs. Thus, if the company has extensively documented the assessment process, the examiner could request this information from company management if the external auditor is slow to provide the examiner the internal control audit (SOX) workpapers.

As previously noted, the PCAOB adopted Auditing Standard No. 5 for auditors to use when assessing whether managers of a public company have accurately reported on the companies' internal controls over financial reporting. This auditing standard can be found in its entirety at the PCAOB homepage, www.pcaobus.org. This document will provide the examiner with additional information, which can shed light on the complexity and nature of the internal control audit. The entire Sarbanes-Oxley Act of 2002, example audit reports, definitions of various terms and other useful information are also available at the website.

The presence of computer processing in the accounting system usually has a significant impact on the examiner's evaluation. Computer-generated data and reports may form the basis for key operating information or recorded annual statement balances. The accuracy of this information depends on the programs and the data files from which they are produced. Accordingly, an evaluation should consider the elements of internal control in a computerized accounting system, including general controls over the development of, and changes to, computer programs and data file access, and application controls over the results of computer processing, as well as the company's processes to help ensure the controls are adequate and effective. While application controls would typically be tested as part of the Phase 3 process, the examiner should consult with the IT specialist to determine whether findings resulting from the IT general controls review

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would impact the examiner's approach to application control testing. See Section 1, Part III, A – General Information Technology Review for a discussion of the process to review a company's IT general controls.

At the completion of Phase 3, the examination team should have identified and evaluated the Risk Mitigation Strategies/Controls for each of the inherent risks pertaining to key activities noted in the risk-focused examination. In Phase 4, the examination team will assess the residual risk of those inherent risks identified.

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PHASE 4 – DETERMINE RESIDUAL RISK

Upon completion of Phases 1 through 3, the examiner will have identified the significant areas of the company, identified and assessed inherent risks within those areas, and identified and assessed controls that attempt to mitigate those risks. In Phase 4, the examiner will determine the residual risk for each of the inherent risks identified.

Residual risk is assessed by determining how well the risk mitigation strategies/controls mitigate the level of inherent risk in the insurer's activities using likelihood of occurrence, magnitude of impact and professional judgment. Residual risk can be assessed on both other than financial reporting and financial reporting risks.

Risks Other Than Financial Reporting
Other-than-financial reporting residual risk is the risk that exists after taking into account the controls established to ensure management's business objectives are being followed. It also includes the risk that is accepted by management (i.e., "acceptable risk"). Other-than-financial reporting residual risks above an acceptable level will generate control improvement recommendations (Phase 7) and communication with the financial analysts (Phase 5 and Phase 6). Testing of other than financial reporting controls/risk mitigation strategies should be considered in Phase 3 in order to determine whether reliance will be placed on controls. This reliance is then reflected within the residual risk rating (e.g., to reduce a high or medium inherent risk to a low residual risk). These other-than-financial reporting risks not only relate to risks "as of" the examination date, but to risks that commence during, or extend beyond, the period under which the examination is conducted, as well as risks that are anticipated to commence during, or extend beyond, the anticipated completion date of the examination, based on company operations that have occurred or are presently occurring. Because of this, it is anticipated that a more significant emphasis on controls/risk mitigation strategies may be appropriate, as it could be difficult or impossible to perform traditional Phase 5 detail testing on these types of risks. If the risk could have an impact on multiple key activities within the company, Exhibit V – Overarching Prospective Risk Assessment may be more appropriate for documenting the risk assessment process for risks occurred or extended, or anticipated to occur or extend, past the date of the examination.

Financial Reporting Risk:
Financial reporting residual risk is the risk remaining after taking into account the controls established to achieve certain objectives in the financial reporting function or process. This residual risk may be the result of:

- A control deficiency, which exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.

- A significant deficiency, which is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance.

- A material weakness, which is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the company's financial statements will not be prevented, or detected and corrected on a timely basis.

Determining residual risk is the key to determining where the risks lie in an insurer's business. Once the riskier activities are identified, the examiner will use these results as the foundation to determine the extent and nature of testing in Phase 5.

Residual Risk Assessment Ratings
The overall residual risk assessment ratings are High, Moderate, and Low and should be documented in the Risk Assessment Matrix.

High Residual Risk – This risk rating generally would be assigned to an activity where the risk management process does not significantly mitigate the high inherent risk of the activity. Thus, the activity could potentially result in a financial loss that would have a significant adverse impact on the organization's overall condition, even in some cases where the processes are considered strong. For financial reporting risk, the existence of control deficiencies and/or material

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weaknesses could indicate a high residual risk. However, the lack of control deficiencies and/or material weaknesses does not exclude a residual risk determination of high. In cases where management appears to have an insufficient understanding of the risk and/or capacity (lack of timely and accurate information or analysis) to anticipate and respond to changing conditions, the examiner may need to re-evaluate their determination of the inherent risk and the residual risk.

Moderate Residual Risk – This risk rating generally would be assigned to an activity having moderate inherent risk where the risk management processes do not appropriately mitigate the risk. However, a strong risk management process may reduce the risks of an inherently high-risk activity so that any potential financial loss from the activity would have only a moderate, short-term, adverse impact on the financial condition of the organization. For financial reporting risk, this could be evidenced, in part, by the existence of control deficiencies, which are typically not considered to be significant or material weaknesses. In cases where management appears to have an insufficient understanding of the risk and/or capacity (lack of timely and accurate information or analysis) to anticipate and respond to changing conditions, the examiner may need to re-evaluate their determination of the inherent risk and the residual risk.

Low Residual Risk – This risk rating generally would be assigned to an activity that has low inherent risks. An activity with moderate inherent risk may be assessed as low residual risk where internal controls and risk management processes are strong and effectively mitigate much of the risk. After considering risk management controls, any potential financial loss from the activity would have minimal impact on the financial strength of the organization. For financial reporting, this could be evidenced, in part, by few or no control deficiencies.

Illustration of the Calculated Residual Risk Assessment

The following calculation should be used as a guide to determine calculated residual risk using the already determined assessments of inherent risk and risk controls. The Residual Risk Calculation is laid out left to right in a linear fashion. An examiner starts with the column on the left by identifying the level of assessed inherent risk as determined in Phase 2 (high, moderate, or low). Next, the examiner identifies the strength of risk controls as determined in Phase 3 (strong, moderate, or weak). The point where the inherent risk assessment and strength of risk controls intersect, results in the calculated residual risk. For example, if inherent risk was assessed as low and risk controls were assessed as strong, then the residual risk would be low. The calculated residual risk is recorded in the Risk Assessment Matrix and utilized to design appropriate examination procedures in Phase 5. This calculation is not intended to force artificial limitations on the examiner and does permit the examiner to utilize professional judgment and experience with the insurer in determining whether the calculated residual risk is appropriate. The examiner is able to record a different level of residual risk (judgmental residual risk) in the Risk Assessment Matrix from what is calculated below and use that assessment when designing examination procedures.

		Control Assessment		
		Strong Risk Controls	Moderate Risk Controls	Weak Risk Controls
Inherent Risk Assessment	High	Moderate or High	Moderate or High	High
	Moderate	Low or Moderate	Moderate	Moderate*
	Low	Low	Low	Low*

* If based on an assessment of weak risk controls, the examiner feels that the residual risk assessment should be higher than the calculated result; the examiner should consider revising the initial assessment of inherent risk and then recalculating residual risk.

Consideration of Judgmental Residual Risk

Although the determination of the residual risk assessment is primarily a calculated component of the examiner's assessment of inherent risks and controls, it is expected that the examiner will judgmentally assess whether the calculated risk is reflective of the examiner's anticipated residual risk assessment for each activity. As considered necessary, the

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examiner may elect to adjust the calculated residual risk to reflect his or her judgmental assessment of residual risks. An example of an appropriate use of judgmental residual risk is when the examiner obtains information subsequent to documenting a particular inherent risk assessment that would have affected the original assessment. If the examiner determines it would not be appropriate or efficient to return to Phase 2 to restate the inherent risk, the examiner may make the adjustment through the utilization of judgmental residual risk. The rationale for the change in inherent risks would need to be documented regardless of whether the change was made in Phase 2 or as part of Phase 4.

Additionally, judgmental residual risk may be utilized when inherent risk is high and controls are found to be strong enough to lead the examiner to believe that no additional testing would be necessary to mitigate the risk. Using the table on the previous page, the lowest residual risk that could be calculated is moderate in this situation. Based upon that result, additional examination procedures would be required. However, if the examiner believes that the strength of the controls substantially mitigates the risk, the examiner may use his or her judgment to adjust the overall residual risk to low. In whatever case that the examiner elects to make judgmental changes to the calculated assessment, the examiner should document the rationale and support for these revisions within the examination workpapers.

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PHASE 5 – ESTABLISH/CONDUCT DETAIL EXAMINATION PROCEDURES

This section of the Handbook addresses the following subjects:

A. Establish/Conduct Detail Examination Procedures
B. Risks Other Than Financial Reporting
C. Financial Reporting Risks
D. Examination Considerations
E. Analytical Review Procedures as Substantive Tests

A. Establish/Conduct Detail Examination Procedures

The Risk Assessment Matrix (Exhibit K) is intended to be an all-encompassing documentation tool incorporating risk assessment, control assessment, examination procedures and results. At the beginning of Phase 5, the Risk Assessment Matrix (or similar documentation) has been completed from left to right up to the residual risk assessment column for each risk identified. At this juncture, after completion of the risk assessment matrix for each risk identified, the nature and extent of testing can be determined and the examination procedures designed accordingly. Examination procedures selected from those procedures set forth in this Handbook, as well as any other procedures warranted for a particular examination, may be imported into the relevant section of the Risk Assessment Matrix (or similar documentation). It is also acceptable to document the examination procedures performed in a separate workpaper and to provide a workpaper reference in the appropriate section of the Risk Assessment Matrix (or similar documentation). Prior to the performance of Phase 5 testwork, planned detail examination procedures should be approved and signed-off on by the chief examiner (or designee) and the examiner-in-charge. Results of the completed examination procedures and where applicable, the disposition of the certain results (i.e., finding and errors), should be documented in the Risk Assessment Matrix (or similar documentation). As discussed in Phase 4, there are three levels of residual risk: high, moderate and low. The following chart indicates the type and amount of testing necessary at each level.

High Residual Risk	Detail procedures required.
Moderate Residual Risk	Fewer detail procedures performed (i.e., tests of details of transactions), including more utilization of analytical procedures.
Low Residual Risk	Limited or no detail procedures performed, which may be limited to analytical procedures.

Although testwork in Phase 5 is generally not required for low residual risks, there are certain situations where some detail tests are necessary to address such risks. For instance, if an examiner deems a low inherent risk to be significant enough to include on the risk matrix in Phase 2 and either does not perform control testing or assesses controls as weak in Phase 3, a minimum amount of detail testing should be performed (e.g., analytic procedures) in Phase 5.

The examiner should also take into consideration the company's compliance with state regulations when establishing and conducting detail exam procedures. Compliance testing may not be required to be performed in accordance with the residual risk assessment. However, it is a state-specific issue to determine the level of testing to be performed on compliance related risks. For example, if compliance with the state's regulations on investments is determined to have a low residual risk, the examiner may choose to test investment compliance at 100% if the examiner's state policy requires it, rather than to reduce the detail testing based on the low residual risk assessment.

B. Risks Other Than Financial Reporting

In addition to conducting an examination to verify the current status of the company's solvency condition, the risk-focused surveillance process requires examiners to prospectively consider the company's financial condition by assessing

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whether the company's current processes provide indications of future solvency concerns. In conducting examinations based on the risk-focused surveillance framework, the examiner should give consideration to the business processes and management controls that often are considered retrospectively after financial issues are diagnosed as indications that a company had potential financial solvency issues. In addition to assessing business risks, other elements that would commonly be assessed for prospective solvency risks include consideration of the company's asset/liability matching approach, process for establishing loss reserves, pricing and underwriting and reinsurance arrangements. Among other things, these assessments should include consideration of the company's rate of growth, or whether the extent of illiquid assets would create future concerns on the company's overall financial solvency.

By the end of Phase 5 of the examination, the examination team should have completed a high-level review of the insurer to ensure that the identified solvency concerns, including those that commenced or extended beyond the examination date, or those that are anticipated to commence or extend beyond the date of the examination completion date, were considered and addressed during the course of the exam. If a potential solvency concern was identified, the examiner should ensure that procedures were performed during the course of the exam to address the concern. For overarching prospective risks identified on Exhibit V, the examiner should have completed the various steps for investigating those risks that are listed in the instructions of Exhibit V by the end of Phase 5.

Due to the nature of some other-than-financial reporting risks, traditional Phase 5 procedures may not be adequate to address all risks. In this case, it would be expected that the residual risk be considered in Phase 6 as an ongoing issue for the analyst or other areas of the department to monitor, and/or in Phase 7 as an item communicated to management. In these circumstances, the examiner has a responsibility to obtain as much information as possible throughout the course of the examination to enhance the ongoing monitoring of the unmitigated risk. If it is determined that an actual solvency condition exists, the examiner should communicate the issue to department senior management. The examiner's documentation and findings pertaining to these risks should be utilized by the department to assess the examination prioritization and supervisory plan of the insurer. This information should be shared internally with financial analysts to enhance the scope of their annual and quarterly reviews. Although it is not anticipated that these prospective assessments would routinely be included within the report of examination or management letter, the respective insurance department may use its discretion to include reference to prospective risks. However, depending on the extent of the risk, plans for significant revisions to the company's operations and the overall assessed stability of the insurer should be considered for inclusion.

Potential business risks have been identified using guidance provided within the NAIC *Troubled Insurance Company Handbook* to identify trends and conditions that are often present at insurers that are moving toward a financial position that subjects its policyholders, claimants and other creditors to greater-than-normal financial risk. These risks and related examination procedures are included in Exhibit V – Overarching Prospective Risk Assessment, Part Two, and within certain examination repositories to assist examiners in formally assessing prospective risks as they complete risk-focused examinations and in communicating findings to the analysts.

C. Financial Reporting Risks

In conducting examination procedures for financial reporting risks, the examiners should consider the results of the residual risk assessment to determine the extent of detail procedures (if any) that should be performed for the identified risks. If the examination procedures provided within this Handbook are utilized, the examiner should determine which procedures to perform by considering whether the procedure addresses the noted risks.

The objectives of the examination as determined by the residual risk assessment can be further evaluated on the basis of financial statement assertions. As indicated by the American Institute of Certified Public Accountants, financial statement assertions are representations by management embodied in financial statement components. While examination assertions and related financial statement assertions remain constant from company to company, they are not equally relevant to a given company as noted risks vary in accordance with the company operations and risk mitigating procedures. Examiners should consider the applicability of the broad categories of assertions in designing examination procedures pertinent to the noted residual risks. The assertions and their descriptions are listed in Phase 3.

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D. Examination Considerations

Following the conclusion of Phase 5 of the examination, the following areas and their related strengths, weaknesses and challenges should be understood by the examination/analysis team and supported within the examination workpapers for the examiner to consider in reporting on exam conclusions and findings in Phase 6 and Phase 7:

Current Strengths and Weaknesses (Findings/Conclusions)

- Board of directors
- Audit function (internal and external)
- IT function
- Risk management processes for key functional (primary business) activities with respect to the applicable nine branded risk classifications. Key functional activities are identified in alignment with the insurer's organizational structure
- Financial condition, performance, and reporting (include insurance holding company, related party transactions/arrangements and reinsurance effectiveness)
- Financial reporting controls and exam financial statement adjustments
- Compliance with laws and regulations

Prospective Risk Indications (Findings/Conclusions)

- Business growth, earnings, capital
- Management competency and succession (includes board of directors)
- Primary challenges:
  - Financial condition
  - Marketplace
  - Operations and financial reporting controls
  - Compliance with laws and regulations

Other Miscellaneous Considerations

- Review of all significant reinsurance contracts for risk transfer
- Review of significant nonstandard journal entries
- Review of premium tax calculations
- Accumulation of misstatements that were identified but not posted (examiner should utilize Exhibit BB – Summary of Unadjusted Errors to accumulate these misstatements).

E. Analytical Review Procedures as Substantive Tests

Substantive tests fall into three categories: 1) analytical review procedures; 2) tests of key items; and 3) tests of representative samples. Judgment is used to determine the most effective and efficient combination of those tests responsive to the assessment of residual risk. This section discusses analytical review procedures as substantive tests and provides guidance on the level of persuasiveness and the need to test the underlying data.

Analytical review procedures may be used: 1) as primary substantive tests of balances; 2) as corroborative tests in combination with other procedures; or 3) to provide at least some minimal level of support for conclusions. Analytical review procedures may provide an efficient alternative to detail tests of account balances and may allow the examiner to consider whether the company's financial information is in line with expectations. In some cases, typically in low and some moderate residual risk accounts, analytical review procedures may effectively be used as the only tests.

Analytical review procedures can be the primary substantive test (i.e., the primary basis for conclusions) if they provide sufficient evidence. That would be the case if the procedures generate an amount believed to be a reasonable estimate of the account balance and is consistent with expectations. Analytical review procedures may include comparisons to prior period, comparisons to budgets or forecasts and comparisons to industry and competitor data.

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Analytical review procedures can also be effective as a check on general reasonableness of accounts, even when not used to estimate the account balance. Analytical procedures often uncover unreasonable relationships or business trends that detail testing might not detect.

Analytical review procedures provide corroborative evidence if they: 1) confirm findings from other tests; and 2) support management's representations or otherwise decrease the level of skepticism. Analytical review procedures that provide only limited corroborative evidence contribute only minimal support for conclusions. In deciding whether an analytical review procedure, or combination of procedures, provides corroborative evidence or only minimal support for conclusions, the examiner should evaluate the extent of analytical review procedures and the quality of the evidence expected to be obtained. For example, if the examiner simply compares a current-year overall balance (e.g., reserves) to the prior-year balance, and does not supplement that comparison with any other analytical review procedures (e.g., lapses, cash surrenders, new issues, loss ratios, premium volume), the examiner would obtain only minimal support for a conclusion.

Before examiners inquire with company representatives, examiners should ensure they understand the work already performed by the department's financial analysts to avoid duplication of work. Examiners are also encouraged to use the work of the financial analyst, as well as software tools such as ACL, to analyze significant amounts of data and increase the effectiveness and reliability of analytical tests.

Evaluating Analytical Review Results

An understanding of the company's business may identify likely fluctuations in the financial data. These fluctuations may be caused by: 1) trends – general changes in business conditions; 2) seasonal patterns – changes in business activity caused by weather or other seasonal changes; 3) cyclical patterns – changes in overall economic activity; or 4) dependent relationships – changes related to movements in other financial data.

Fluctuations that cannot be explained from knowledge of the company's business or by known relationships with other financial data may result from non-recurring transactions, erroneous accounting procedures or practices, or other factors. When unexpected significant fluctuations in amounts or key relationships occur, or when expected fluctuations do not occur, the examiner should find out why. Initial follow up procedures should include discussions with operating executives and financial management. Management may have already determined the cause of the variations; if not, the examiner may save time by pursuing these matters. The examiner should challenge the reasonableness of management explanations in view of the examiner's understanding of the business and the examiner's expectations.

The examiner should consider how the company's ability to respond to reasonable analytical inquiry would affect the evaluation of the competency of management. Well-managed companies will often be able to answer questions about key relationships or will pursue the root cause of unexpected fluctuations.

Testing Underlying Data Used in Analytical Review

If analytical review procedures are used in phase 5 during the performance of detail testing, judgment should be used in determining the need for, or the extent of, tests of the underlying data. Operating data generated independently of the accounting system may not need to be tested as extensively as data generated by the accounting system. The examiner also should keep in mind that computer-generated data used in corroborative analytical review procedures may only be relied on based on the results of the examiner's IT review (e.g., effective or ineffective).

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PHASE 6 – UPDATE PRIORITIZATION AND SUPERVISORY PLAN

Relevant and material findings resulting from the risk assessment effort and any other examination activities should be utilized and incorporated into determining (or validating) the priority of the insurer, as well as establishing the Supervisory Plan. The examination results and/or findings are key elements that should be considered when updating the insurer's prioritization or Supervisory Plan as the solvency or management conditions noted within these reports and within the financial analysis workpapers should drive the determination of future monitoring activities. While the financial analyst generally maintains the supervisory plan and tracks prioritization, a good means of communicating exam issues that may affect the supervisory plan or have implications on prioritization levels is through use of Exhibit AA – Summary Review Memorandum.

A. Prioritization

Prioritizing insurers is a qualitative and quantitative process and can be accomplished through the use of various applications. Applications include any state-based prioritization applications and/or any NAIC applications such as: the Scoring System, Risk-Based Capital (RBC) Calculation, and the Insurance Regulatory Information System (IRIS) Ratios. It is recommended that the prioritization of insurers not be based on one application alone but that use multiple applications, examination results and other financial tools such as the Insurer Financial Profile Report and the Financial Analysis Handbook. A brief overview of the NAIC applications has been provided below. Regulators can obtain further information on the use of these tools by referencing the Handbooks developed in response to these tools.

The Scoring System – This System provides a series of ratios that identify solvency risks and score the result through the use of multiple annually calibrated ranges based on insurer results and market conditions. The ratios focus on profitability, leverage, assets and liquidity, and operations. The key concept of the Scoring System is to focus on those insurers that have the highest total score related to the aforementioned categories.

Risk-Based Capital Calculation – The RBC ratio calculates the minimum capital requirement an insurer must maintain. The calculation results in various Action and Control Levels for insurer ratio results that fall within a certain percentage range.

IRIS Ratios – The IRIS Ratios are the NAIC's only public prioritization application and provide ratio results for the key solvency indicators related to overall, profitability, liquidity, reserve, investments, and operations. Those ratios that fall outside a usual range are identified.

B. Supervisory Plan

At least once a year, a supervisory plan should be developed or updated by the domestic state for each domestic insurer using the results of recent examinations and the annual and quarterly analysis process. Using the lead state concept, the lead state should try and coordinate the ongoing surveillance of the companies in the group with input from other affected states (with the understanding that the domestic state has the ultimate authority over the regulation of the domestic insurer under its jurisdiction) when preparing the plan. That supervisory plan should be concise and outline the type of surveillance planned, the resources dedicated to the oversight and the coordination with other states. A proposed supervisory plan outline is provided in Section 4 as Exhibit U. If the insurer is in a stable financial position, the supervisory plan typically will not be extensive and, therefore, it may be more efficient to house it within the Insurer Profile Summary rather than as a separate document.

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PHASE 7 – DRAFT EXAMINATION REPORT AND MANAGEMENT LETTER

This section of the Handbook addresses the following subjects:

A. Examination Report
B. Management Letter
C. Summary Review Memorandum
D. Letter of Representation

A. Examination Report

The Examination Report should only include significant findings of fact, as mentioned in the *Model Law on Examinations* (#390) and general information about the insurer and its financial condition. In a full-scope examination, the report will contain the standard information as set forth below. In a limited-scope examination, the examination is limited to a review of specific financial statement items or risk areas and the same reporting process is followed. See additional guidance for creating a report on a limited-scope examination in Section 1, Part X (letter E) of this Handbook.

1. Definition and Purpose

   A full-scope examination is defined as an examination in which the scope of the control testing and detail procedures to be performed during the examination is based on the implementation and documentation of the risk assessment procedures required under this Handbook. The primary purpose of a risk-focused examination is to review and evaluate an insurer's business processes and controls to assist in assessing and monitoring its current financial condition and prospective solvency. As part of this process, the examiner identifies and evaluates significant risks that could cause an insurer's surplus to be materially misstated both currently and prospectively. A full-scope examination report shall include information relevant to the financial condition, as well as corporate governance, and set forth findings of fact (together with citations of pertinent laws, regulations and rules) with regard to any material adverse finding (e.g., event, trend, transaction or series of transactions, fluctuation, agreement, arrangement, operating result or violation of law, which either has, or reasonably could have, a significant negative impact on a company's financial position) disclosed by the examination. A full-scope examination meets the requirements of the NAIC Financial Regulation Standards and Accreditation Program.

2. Format

   The report of examination should be structured and written to communicate to regulatory officials the examination findings of fact that are of regulatory importance. It should be written in a manner understandable by someone who is unfamiliar with the company examined. Thus, when discussing certain findings, it may be necessary to provide some background information. However, such information should be limited to data relevant to the issue involved and should be presented as succinctly as possible.

   Each report of a full-scope examination should be dated to coincide with the last date of fieldwork and contain the following sections:

   a. Table of contents (with contents and pages denoted).

   b. Salutation (address the report to the commissioner of the domiciliary state for all exams).

   c. Scope of the examination (the period covered by the current examination, including the last examination date; an explanation of how the examination was conducted and what it entails; and the accounts and activities that were examined, including the key activities of the company):

      We have performed our [indicate insurer type (i.e., multi-state or single-state)] examination of *(Insurance Company's Name)*. The last examination covered the period of _____ through _____. This examination covers the period of _____ through _____.

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We conducted our examination in accordance with the NAIC *Financial Condition Examiners Handbook*. The Handbook requires that we plan and perform the examination to evaluate the financial condition, assess corporate governance, identify current and prospective risks of the company and evaluate system controls and procedures used to mitigate those risks. An examination also includes identifying and evaluating significant risks that could cause an insurer's surplus to be materially misstated both currently and prospectively.

All accounts and activities of the company were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made by management and evaluating management's compliance with Statutory Accounting Principles. The examination does not attest to the fair presentation of the financial statements included herein. If, during the course of the examination an adjustment is identified, the impact of such adjustment will be documented separately following the Company's financial statements.

This examination report includes significant findings of fact, as mentioned in the [*Insert Examination Law Statutory Citation*] and general information about the insurer and its financial condition. There may be other items identified during the examination that, due to their nature (e.g., subjective conclusions, proprietary information, etc.), are not included within the examination report but separately communicated to other regulators and/or the company.

d. Body of Report

The body of the report shall contain the following:

- Summary of significant findings of fact (material adverse findings, significant non-compliance findings (such as non-compliance with state law(s), SSAPs, annual financial statement instructions, etc.), material changes in financial statements, update on other significant regulatory information disclosed in the previous examination).
- Company history. The primary focus should be the examination period (e.g., dividends and capital contributions, mergers and acquisitions), but may include significant historical events (e.g., name changes, transfers of business, significant changes to key company trends and ratios, etc.).
- Management and control, including corporate governance (which may include a list of directors, senior officers and principal internal committee members, with name, title and location and a review of corporate records). Also, if the insurer is a member of a holding company, include an organization chart, summary of cost-sharing agreements and any regulatory information concerning the parent, subsidiaries and affiliates that could have a significant impact on the solvency of the company. As exam reports should only contain findings of fact, the corporate governance assessment(s) is considered subjective and does not lend itself for inclusion in the report.
- Territory and plan of operation (jurisdictions in which the company is licensed and transacting business, the products written, etc.).
- Reinsurance (include an overall description of the company's ceding and/or assuming reinsurance methodology).
- Financial statements, as reported and filed by the Company with the State Department of Insurance, are reflected in the following:
    - Statement of assets and liabilities
    - Statement of operations
    - Supporting schedules and exhibits to the extent needed
    - Reconciliation of capital and surplus.
- Analysis of changes in financial statements resulting from the examination.
- Comments on financial statement items (comments concerning non-compliance, adverse findings or material changes to the financial statements, which may include a more in-depth discussion of items covered in "Summary of Significant Findings").

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- Subsequent events (any significant subsequent event identified by the examiner through the date of the examination report).
- Summary of recommendations (company improvements in processes, activities and/or controls).
- Signature page (signatures of Examiner-In-Charge and any other individuals deemed necessary by the state).

When presenting the financial statements within the body of the report, the report should include language that identifies that the statements were prepared by management and are therefore the responsibility of management. Examiners do not maintain responsibility to issue an opinion on the financial statements and should refrain from doing so. Examiners do retain responsibility to report material adjustments to surplus that come to their attention as a result of the examination. As such, any adjustments identified by the examiner and presented in the report should be included separately alongside with an explanation of the impact on surplus, if any. Language introducing the financial statements should be included and an example is as follows:

> The following financial statements are based on the statutory financial statements filed by the company with the State Department of Insurance and present the financial condition of the company for the period ending December 31, 20XX. The accompanying comments on financial statements reflect any examination adjustments to the amounts reported in the annual statement and should be considered an integral part of the financial statements.

If adjustments are identified during the examination, the impact on surplus should be described in the accompanying comments. Alternatively, the report should state that no adjustments were made to surplus as a result of the examination. The following table may be used to show the increase/decrease in surplus.

Analysis of Changes to Surplus			
Surplus at Dec. 31, 20XX, per Annual Financial Statement			$ X,XXX
	Increase	**Decrease**	
Statement Line Item	$XXX,XXX		
Statement Line Item		$XXX,XXX	
Net increase (or decrease)			$XXX
Surplus at Dec. 31, 20XX, after adjustment			$ X,XXX

For reclassifications made as a result of the examination that do not impact surplus, the following table may be used to show the change in each annual financial statement line item impacted.

Summary of Reclassifications				
Annual Statement Line Item	**Balance per Annual Statement**	**Increase**	**Decrease**	**Adjusted Balance**
Line Item 1	$_____	$_____	$_____	$_____
Line Item 2	$_____	$_____	$_____	$_____

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In addition to the elements above, the body may also contain a section for significant changes occurring during the examination period and/or other issues which are identified during the course of the examination. This section shall be reported at the discretion of the EIC. This may include fidelity bond and other insurance, pensions and stock ownership, mortality and loss experience, accounts and records, statutory deposits, key company trends and ratios, and other areas deemed necessary by the EIC.

If the examination of any account or activity does not identify either a significant adverse finding, a material change in the financial statements or other information of regulatory significance or requiring regulatory action, it is not necessary to comment on the account or activity in the body of the report.

If the examination report contains a critical finding in reference to any part of the company's activities, the finding should be supported adequately by evidence set forth in, or appended to, the report or included in the workpapers. This evidence should be available to support the findings if a hearing is called on the report or if a disciplinary proceeding is based upon it.

Any transaction consummated by a company subsequent to the effective date of an examination, which is for the purpose of adjusting the company's previously reported financial condition, shall not be recognized in the financial statements included in the report of examination. Such transaction may be described by a qualifying statement, or statements, when supported by a reference to the original minutes or document evidencing such subsequent transaction or transactions. Such supporting data shall be set forth in a clearly captioned appendix, or appendices, to the report.

3. Timing

Reports should be prepared and distributed in a timely manner as set forth in statute. Examination reports should be dated as of the last day of fieldwork and should be issued no later than 120 days subsequent to this date. As a general rule, examination reports should be issued no more than 18 months after the "as of" date. Exceptions to timing requirements should be properly documented and should identify the nature and cause of the exception, as well as the regulatory response. Requirements regarding the timeliness of exam reports and exceptions to the 18-month rule are discussed further in Section 1, Part A (letter I) of this Handbook.

4. Multi-Entity Reporting

When an examination of an insurance company group with multiple entities domiciled in the same state is conducted, it may be suitable to prepare one report of examination if such an approach is simpler due to the nature of the company(s). This approach could apply to, but is not limited to, examinations of pooled entities. This approach is optional and should only be applied when deemed appropriate by the financial regulation division of the applicable state. Information that is identical for multiple entities need not be repeated as long as it is clear what information pertains to which entity(s). To the extent that information is unique to a specific company (e.g., financial statements), such information should be reported separately within the report of examination. In implementing this optional reporting format, the following criteria apply:

- All companies to be reported in the multi-entity examination report must be domiciled within the same state.
- Requirements for information to be reported in the body of the examination report, as defined in section 2.d above remain.
    - When the required information applies to multiple companies, it may be presented once, with an indication to which company(s) the information is applicable. Such information should not be consolidated to the extent that required information related to a specific legal entity(s) is omitted.
    - To the extent that the information to be reported differs by legal entity, such as financial statements, it must be presented separately within the examination report.

When the department decides to prepare one report of examination in accordance with the guidance in this section, a comment citing the intention should be included in the examination call within FEETS. Including a comment in the

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FEETS notification ensures that all states required to receive the report are informed at the start of the exam and that any concerns can be addressed at this time.

B. Management Letter

Significant results and observations noted during the examination that are not appropriate or necessary for inclusion in the public report, as determined by the state insurance department conducting the examination, should be communicated to the board and/or management. A management letter is considered an examination workpaper and may be used for this purpose. Those states not utilizing the management letter should communicate comments to the board and/or management during the exit conference or other means deemed appropriate. For group examinations, the lead state, after discussion with other participating states, will determine which results and observations will be included. The letter to management, or other means of communication as determined by the state, can serve as a vehicle for an ongoing dialogue between the regulator and the insurer and should be shared with those states an insurer is licensed in, assuming as confidentiality can be maintained. This letter or communication should be issued and delivered by the regulators to the board members and/or management based on the scope and severity of the issues identified. The examiner should request a response from the company regarding the plan to address the identified issues. This response should be received within a reasonable time frame (e.g., 90 days) from the date the examiner issued the letter or communication. In addition to communication with the insurer, the examiner is responsible for communicating significant results and observations to the analyst and should consider including the analyst throughout the communication process with the insurer. In accordance with the *Financial Analysis Handbook*, the analyst must follow-up and document a review of any management letter comments. The examiner should coordinate with the analyst on the follow-up of the identified issues. As the examiner moves on to other examinations, it is important that the analyst be involved with the resolution and monitoring of the identified issues.

Example Management Letter
An example management letter template has been developed below to provide a suggested format to examiners in drafting this correspondence. As with the elements that may be included within these non-public letters, the actual format utilized should be determined by the state insurance department conducting the examination.

June 1, 20XX
Board of Directors
XYZ Insurance Company (XYZ)

The Board of Directors (Board) has a duty to ensure that XYZ Insurance Company is operated in a safe and sound manner in the best interest of the policyholders. The Department of Insurance (the Department) is charged with the responsibility to protect insurance consumers and other creditors.

Following are comments related to the examination of XYZ Insurance Company as of December 31, 20XX, and other related information regarding XYZ. The Department has identified the following issues and concerns regarding specific operations or practices of the company. In accordance with the nature of these items, the department has chosen not to include these comments within the Report of Examination.

For each item/issue noted:

- State the issue using a concise statement of the problem identified;
- Provide commentary on the examiner's understanding on what caused or created this issue;
- Illustrate the effect of this issue including the materiality impact, and what impact it has had on the financial statements, the company's financial condition, or company operations; and
- [illegible]tion regarding the criteria that elevated this issue (i.e., non-compliance with statute).

We will review the response and determine what further actions are appropriate. Please contact me by telephone (*number*) or email (*xxxxx@xxxxx*) if you have any questions.

Sincerely,
Examiner

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C. Summary Review Memorandum

Examiners should complete Exhibit AA – Summary Review Memorandum (SRM), or a substantially similar document, in conjunction with completion of the exam. Information communicated through completion of the SRM includes discussion of potential ongoing or future solvency concerns the insurer may face, the insurer's corporate governance, and a summary, by branded risk classification, of prospective solvency concerns, examination adjustments, control/risk mitigation strategy issues, report findings and management letter comments, responses to issues raised by financial analysis, subsequent events and other residual risks or concerns the examiner may want to communicate to department personnel. The SRM is a useful tool to ensure all relevant information and findings resulting from the examination are properly communicated to the analyst, chief examiner or any other potential regulatory users. Proper completion of this document may also help ensure that the examination is in compliance with the accreditation requirement that documentation of the results of the on-site examination activities be shared with the assigned analyst.

D. Letter of Representation

A letter of representation should be obtained from management as part of every examination. The examiner should utilize Exhibit T – Sample Letter of Representation, which provides a template that should be customized to the insurer under examination. See Section 1, Part IV, G – Letter of Representations for additional guidance.

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SECTION 3—EXAMINATION REPOSITORIES

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BACKGROUND

The examination (exam) repositories in this section were created to assist examiners in identifying the most common risks related to a critical risk category that are often inherent within different key activities of a typical insurance company. The intent of the repositories is to provide a tool to assist examiners in determining which risks might be relevant in addressing a critical risk category during an examination. The exam repositories are not intended to provide an all-inclusive listing of potential risks, nor to provide a minimum baseline of which risks are required to be identified on all exams. The repositories are fluid documents and, as such, will be modified and updated with relevant risks and exam procedures as deemed necessary. Only the most common risks related to a critical risk category have been included in these exam repositories to allow more flexibility and customization in identifying risks within key activities of the insurer. An additional supplement with a more comprehensive list of common risks is available on the NAIC website. Instructions for accessing the updates on the website are located at the front of this Handbook. Included with the identified risks are examples of common controls, tests of controls and examples of how an examiner may choose to test the details of each identified risk.

Identified Risks

The identified risks provided within the exam repositories are not designed to be an all-inclusive list and may not apply to all insurance companies that are under examination. The examiner's understanding of the insurer obtained in Phase 1 should be used to determine which risks included in these exam repositories are applicable to the insurer. The insurer will likely have additional risks associated with the different key activities that have not been included within the exam repositories. The examiner must determine which additional risks not included in these exam repositories should be examined as part of the review of the insurer's processes.

Possible Controls

The possible controls provided within the exam repositories are the most common ways in which insurers mitigate the specific risks identified. These controls are common for a typical insurance company but may not apply to each individual insurer. Each insurer has its own controls in place to mitigate the identified risks, which may or may not correspond to the controls identified within the exam repositories. It is possible that the insurer has adequate controls in place, even if the control does not match the possible controls listed in the exam repositories. Additionally, it is possible that a review of multiple controls would be necessary to fully mitigate the risk identified.

Possible Tests of Controls

The possible tests of controls in the exam repositories are not designed to be an all-inclusive list, nor are they intended to be a list of procedures required to be performed on all examinations, as some of the procedures may not apply to the insurer under examination. If the insurer's controls do not match the control best practices, the examiner should not use the possible tests of controls provided within the exam repositories. In this case, the examiner needs to develop alternative tests of controls based on how the insurer mitigates the identified risk. If the examiner intends to place reliance on the control, the examiner is required to assess its design and operating effectiveness, regardless of whether the insurer's control matches the best practice provided.

Possible Detail Test Procedures

The additional detail tests provided within the exam repositories are not designed to be an all-inclusive list, nor are they intended to be a list of procedures that are required to be performed on all examinations, as some of the procedures may not apply to the insurer under examination. In some circumstances, the examiner will need to develop additional detail test procedures beyond what are included within the exam repositories. In all cases, examiners should conduct detail tests, where necessary, based on the assessed residual risk for each risk identified.

Both the possible control tests and detail tests listed are simply suggestions as to what the examiner may be able to perform to test the risk identified. Some of the tests listed in the detail test column are attribute tests and are denoted with an asterisk (*). The detail tests so noted may be used as control tests. However, they are included in the detail test column because the tests would generally require more time and detail testwork than those control tests listed in the Possible Tests

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of Controls column. In general, most of these tests are not testing dollar amounts, but, rather, are testing attributes. As such, when performing these tests as detail tests, examiners should use the Test of Controls Sampling Worksheet (included as part of Exhibit O) but may consider using a lower Tolerable Rate than what is listed on the worksheet, and thus a larger sample size, if placing a great deal of reliance on the detail procedure.

Jumpstart Reports

Throughout the examination repositories, Jumpstart reports are referenced as a possible tool when conducting detailed test procedures for certain risks. The NAIC performs high-level quality assurance validations for these reports and will contact the insurer, when applicable, to follow up on identified errors. These letters can be found within the tools available on I-Site+ (Financial Correspondence). The examination should consider reviewing this correspondence prior to reaching out to the insurer.

Use of a Specialist

The examiner should consider seeking the assistance of an actuary and/or other specialist(s) in performing his/her review related to certain key activities. In particular, the performance of reserving calculations and rate calculations lend themselves to being tested and reviewed by a credentialed actuary.

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Examination Repositories Legend:

Examination Assertions		
Assertion	**Symbol**	**Description**
Accuracy	AC	Transactions are initially recorded correctly, timely and accurately.
Completeness	CO	All transactions that occurred are initially entered into the accounting records, accepted for processing, and generated data files and reports reflect that all transactions have occurred.
Compliance	CM	Transactions are conducted in accordance with state insurance codes, other state laws and/or department directives.
Cut-off	CT	Transactions are recorded in the correct accounting period.
Existence	EX	Transactions occurred and are not fictitious; assets and liabilities exist as of the balance sheet date.
Obligation and Ownership	OB/OW	Liabilities are obligations of the company, and assets are rights of the company at the balance sheet date.
Valuation	VA	Assets and liabilities are valued in accordance with NAIC and applicable state laws and/or regulations.
Presentation and Disclosure	PD	Elements of the annual statement are properly classified, and all disclosures are accurate.

Branded Risk Classifications		
Risk	**Symbol**	**Description**
Credit	CR	Amounts actually collected or collectible are less than those contractually due or payments are not remitted on a timely basis.
Legal	LG	Nonconformance with laws, rules and regulations, prescribed practices, or ethical standards (in any jurisdiction in which the entity operates) will result in a disruption in business and financial loss.
Liquidity	LQ	This risk is the inability to meet contractual obligations as they become due because of an inability to liquidate assets and/or obtain adequate funding without incurring unacceptable losses.
Market	MK	Movement in market rates or prices, such as interest rates, foreign exchange rates or equity prices adversely affects the reported and/or market value of the investments.
Operational	OP	This is the risk of financial loss resulting from inadequate or failed internal processes, personnel and systems, as well as unforeseen external events.
Pricing/ Underwriting	PR/UW	Pricing and underwriting practices are inadequate to provide for risks assumed.
Reputation	RP	Negative publicity, whether true or not, causes a decline in the customer base, costly litigation and/or revenue reductions.
Reserving	RV	Actual losses and/or or other contractual payments reflected in reported reserves or other liabilities will be greater than estimated.
Strategic	ST	The inability to implement appropriate business plan, to make decisions, to allocate resources or to adapt to changes in the business environment will adversely affect competitive position and financial condition.

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Critical Risk Categories		
Category	**Symbol**	**Description**
Valuation/ Impairment of Complex or Subjectively Valued Invested Assets	VIIA	This category encompasses the valuation of particularly complex or subjectively valued investment holdings significant to the insurer, including assets that are hard-to-value, high-risk and/or subject to significant price variation, with a focus on current valuation. The likelihood of security impairment and determination of whether those impairments are other than temporary would also be an area to consider.
Liquidity Considerations	LC	This category encompasses the ability of the insurance company to meet current contractual obligations, which could include liquidating assets or obtaining adequate funding without incurring unacceptable losses. This category is most relevant for near-term cash flow needs that could impact the insurer (one to two years).
Appropriateness of Investment Portfolio and Strategy	AIPS	This category encompasses whether the insurer's investment portfolio and strategy are appropriately structured to support its ongoing business plan. Considerations may include elements of the ongoing investment strategy such as asset diversification, quality, maturities and risk/reward considerations which could impact the insurer's vulnerability to future market fluctuations and impairments. For long-term lines of business, these considerations would address asset adequacy testing/liability matching.
Appropriateness/ Adequacy of Reinsurance Program	AARP	This category encompasses the overall reinsurance strategy of the insurer, whether the strategy is appropriate to support its ongoing business plan and whether adequate coverage is in place to address the insurer's risk exposures (e.g., catastrophe risks, morbidity risk, etc.). Considerations may include the quality of reinsurance counterparties, types of coverage in place, associated limits, net retentions, concentration of reinsurance cessions, coverage levels, terms, affiliated agreements, etc.
Reinsurance Reporting and Collectibility	RRC	This category encompasses whether all reinsurance amounts are properly accounted for and reported by the insurer. Considerations may include the existence and valuation (including collectibility) of reinsurance recoverables and reserve credits. In addition, proper accounting and reporting/disclosure for risk transfer issues may be considered.
Underwriting and Pricing Strategy/Quality	UPSQ	This category encompasses whether the insurer has appropriate underwriting, pricing and marketing practices (including premium management) to meet its financial solvency needs. Considerations may include whether the insurer has established and implemented appropriate risk exposure limits and underwriting guidelines, whether the insurer is establishing adequate rates for the assumed risks and expense structure, and whether these strategies and practices are consistently applied across distribution channels.
Reserve Data	RD	This category encompasses whether selected elements of the underlying data used by the actuary in reserve calculations are complete and accurate. Considerations may include claim or in-force data depending on the lines of business and reserving methodologies used by the insurer.
Reserve Adequacy	RA	This category encompasses the overall accuracy and adequacy of the reported reserves. Considerations may include the assumptions and methodologies used, as well as the accuracy of reserve calculations. This category may apply to various forms of significant reserves carried by an insurer including life reserves, incurred but not reported (IBNR) reserves, case reserves, loss adjustment expense (LAE) reserves, policy reserves, premium deficiency reserves, etc.
Related Party/Holding Company Considerations	RPHCC	This category encompasses transactions and agreements arising from relationships with affiliates that affect the insurer's ongoing solvency position. Considerations may include inequitable contract provisions, the impact of guarantees, contagion risks extending from holding company operations, intercompany tax issues, etc.
Capital Management	CMT	This category encompasses the company's ability to assess, manage and maintain sufficient capital to sustain its business plan and solvency position. Considerations may include the ability to forecast capital needs and obtain additional capital, if necessary.

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EXAMINATION REPOSITORY – CAPITAL AND SURPLUS

Own Risk and Solvency Assessment (ORSA)

During the review of the ORSA filing (if applicable), the examiner may identify risks and controls that are relevant to be considered when creating the Capital and Surplus Key Activity Matrix. Additionally, examiners may perform test procedures related to the information contained within the ORSA filing that provides evidence regarding the sufficiency of an insurer's capital and surplus. Examiners are encouraged to leverage the information contained within the ORSA, and associated test procedures, when populating the Key Activity Matrix.

Annual Statement Blank Line Items

Listed below are the corresponding Annual Statement line items that are related to the identified risks contained in this exam repository:

Capital Notes and Interest Thereon
Aggregate Write-ins for Special Surplus Funds
Common Capital Stock
Preferred Capital Stock
Aggregate Write-ins for Other than Special Surplus Funds
Surplus Notes
Gross Paid-in and Contributed Surplus
Unassigned Funds (Surplus)
Treasury Stock

Relevant Statements of Statutory Accounting Principles (SSAPs)

All of the relevant SSAPs related to other liabilities and surplus, regardless of whether or not the corresponding risks are included within this exam repository, are listed below:

No. 41 Surplus Notes
No. 72 Surplus and Quasi-reorganizations

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
Other Than Financial Reporting Risks						
The insurer is not monitoring its capital and surplus needs, including how changes may impact RBC and financial strength ratings from rating agencies. **Please Note**: Examiners should utilize information contained in the Own Risk and Solvency Assessment (ORSA) provided by insurers that are subject to this filing requirement.	LQ	Other	CMT	Management performs capital modeling calculations, including assessing capital and liquidity needs in normal and stressed environments, to understand the insurer's current and prospective capital needs. The board of directors (or committee thereof) reviews and approves the capital modeling results performed by management on an annual basis.	Obtain evidence of the capital modeling calculations performed by management, including self-validation efforts. Review the board of directors' (or committee thereof) meeting minutes for evidence of the board's approval of the capital modeling results.	Consider utilizing an actuarial specialist to assist with detail test procedures. Consider applying a wide range of scenarios, including severely stressed scenarios, to verify the insurer's available capital is adequate to meet its current and prospective capital needs. Consider the impact of different scenarios on RBC and/or rating agency assessments. Review the insurer's capital modeling and evaluate the appropriateness of input assumptions, methodologies and considerations used in quantifying available capital and risk capital. In the case of stochastic or deterministic modeling, document consideration of appropriateness of diversification of risks.
The insurer does not have access to	ST	Other	CMT	Management performs ongoing analysis of various	Review documentation describing the insurer's	Perform a review of management's available

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
sufficient capital to support its ongoing and future business needs. **Please Note**: Examiners should utilize information contained in the Own Risk and Solvency Assessment (ORSA) provided by insurers that are subject to this filing requirement.				sources of capital (e.g., issuing bonds, selling common stock, parent contributions, borrowing, etc.) to ensure the insurer maintains a current understanding of the options available. The board of directors (or committee thereof) reviews and approves the strategic capital management plan, including sources of capital, on an annual basis.	overall capital management strategy and the options available to raise capital. **Please Note**: When the source of capital is from an affiliate, consider testing in conjunction with the Related Party Repository. Review the board of directors' (or committee thereof) meeting minutes for evidence of the Board's approval of the overall capital strategy plan and the various options available to raise capital, should the need arise.	sources of capital and assess the feasibility of each option to confirm the insurer has access to sufficient capital, should the need arise. **Please Note**: When the source of capital is from an affiliate, consider testing in conjunction with the Related Party Repository.
The insurer is not effectively managing its gross leverage.	ST CR	Other	AARP	The insurer has established and documented gross leverage limits that are reviewed and approved by senior management. The insurer periodically evaluates its gross leverage and adjusts, as needed.	Review documentation of gross leverage limits and evidence of senior management review/approval.	Review the reasonableness of the insurers gross leverage limit by benchmarking against industry standards.
Financial Reporting Risks						
The underlying quality of the company's capital is not sufficient to support its ongoing and future business operations.	LQ CR OP	AC EX VA PD	CMT	The insurer monitors assets to ensure the quality of capital will support its ongoing business needs. Underlying assets to be considered may include: • Deferred tax assets • Significant receivables • Goodwill • Investment in subsidiary • Encumbered assets	Verify the insurer's process to monitor the quality of underlying assets in relation to required capital needs.	Verify the accuracy of reported amounts for selected assets to determine the quality as they support the insurer's surplus. Include consideration of the liquidity of the assets under review. Review the make-up of the insurer's capital and assess how the categories (e.g.,

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				• Defined benefit pension asset The insurer maintains documentation regarding permitted practices that could impact the quality of available capital and reviews all associated calculations to ensure compliance.	Obtain documentation of the insurer's review of its compliance with permitted practices.	common stock, preferred stock, surplus notes, paid-in-capital, etc.) support the ongoing and future business operations. Review the insurer's calculations to ensure they comply with the permitted practices granted by the domiciliary insurance commissioner. Review the effects of the permitted practice on RBC calculations, including subsequent examination adjustments.
The insurer is not accurately calculating, reporting and monitoring RBC.	OP	CM	CMT	RBC calculations are performed in accordance with instructions and subject to supervisory review. The company has a process to ensure that RBC reports and supporting data are filed with the NAIC in a timely and complete manner.	Test controls relating to the insurer's supervisory review process for RBC. Review the NAIC RBC cross-check letter from the insurer to the NAIC, if applicable, and response letter from the insurer to determine the completeness and accuracy of the insurer's RBC report. Contact the NAIC quality assurance department if such correspondence is unavailable. Test the insurer's reconciliation of supporting data back to the system and/or source	Obtain and review the insurer's supporting workpapers to test whether material values in the RBC report were properly classified, valued and included (e.g., catastrophe risk exposure data, C-3 Phase II). (This procedure may only be necessary for values not obtained directly from the annual financial statement and not subject to the NAIC RBC crosscheck procedures.) Determine the impact of examination changes on the RBC calculation. Compare the modeling approaches, assumptions and data filed in support of

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				documentation. The company utilizes the same modeling approach, assumptions and data to determine significant components of its RBC charge (e.g., catastrophe risk exposure, C-3 Phase II) as it uses for its own internal risk management and regulatory accounting/reserving purposes.	documentation. Test the operating effectiveness of company controls to verify that modeling approaches, assumptions and data used to determine significant components of RBC charges are reconciled/agreed to those used in internal risk management and accounting/reserving processes.	RBC calculations with those used by the company for internal risk management and regulatory accounting/reserving purposes. Investigate any significant variances for appropriateness.

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EXAMINATION REPOSITORY - INVESTMENTS

Annual Statement Blank Line Items

Listed below are the corresponding Annual Statement line items that are related to the identified risks contained in this exam repository:

Bonds
Stocks (Preferred and Common)
Mortgage Loans on Real Estate
Cash, Cash Equivalents and Short-Term Investments
Derivatives
Other Invested Assets
Securities Lending – Reinvested Collateral Assets

Other Annual Statement line items related to investments, whose risks are less common, have not been included in this examination repository. They include the following:

Real Estate
Aggregate Write-Ins for Invested Assets
Contract Loans
Receivables for Securities
Payable for Securities
Investment Income Due and Accrued *(P&C Companies)*
Drafts Outstanding
Unearned Investment Income *(Life Companies)*
Liability for Deposit-Type Contracts *(Life Companies)*
Miscellaneous Liabilities – Asset Valuation Reserve
Contract Liabilities Not Included Elsewhere – Interest Maintenance Reserve
Contract Liabilities Not Included Elsewhere – Surrender Values on Cancelled Contracts *(Life Companies)*

Relevant Statements of Statutory Accounting Principles (SSAPs)

All of the relevant SSAPs related to the investment process, regardless of whether or not the corresponding risks are included within this exam repository, are listed below:

No. 2R Cash, Cash Equivalents, Drafts, and Short-Term Investments
No. 7 Asset Valuation Reserve and Interest Maintenance Reserve
No. 21R Other Admitted Assets
No. 23 Foreign Currency Transactions and Translations
No. 26R Bonds
No. 30R Unaffiliated Common Stock
No. 32 Preferred Stock
No. 34 Investment Income Due and Accrued
No. 37 Mortgage Loans
No. 38 Acquisition, Development and Construction Arrangements
No. [illegible] Mortgages
No. 40R Real Estate Investments
No. 41R Surplus Notes
No. 43R Loan-Backed and Structured Securities
No. 44 Capitalization of Interest
No. 48 Joint Ventures, Partnerships and Limited Liability Companies

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No. 49 Policy Loans
No. 56 Separate Accounts
No. 74 Insurance-Linked Securities Issued Through a Protected Cell
No. 83 Mezzanine Real Estate Loans
No. 86 Derivatives
No. 90 Impairment or Disposal of Real Estate Investments
No. 93 Low Income Housing Tax Credit Property Investments
No. 97 Investments in Subsidiary, Controlled and Affiliated Entities
No. 103R Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
Other Than Financial Reporting Risks						
The insurer's investment portfolio and strategy are not appropriately structured to support its ongoing business plan.	RK CR	Other	AIPS LC	The insurer has a governance structure that routinely challenges, approves and reviews its investment strategy and portfolio in conjunction with the risks facing the business. The insurer considers, current market conditions (including interest rates) and takes into account shifting markets and near-term expectations. The insurer has an investment strategy based on, or tolerance for market risks (including asset price volatility, securities lending and interest rate risks) with guidelines as to the quality, maturity/duration, expected rates of return, different investment structures and diversification of investments. The insurer has an investment strategy that outlines asset allocation by asset type, credit quality, duration and liquidity, with acceptable ranges based on the different investments and their specific characteristics. Correlations across different assets are	Review the insurer's investment committee and governance structure related to the portfolio decisions. Consider level of expertise in relation to the complexity of the company's investment strategy, as appropriate. Review recent committee minutes for evidence of discussions related to future market expectations. Review the insurer's investment policy to determine if guidelines relating to the quality, maturity and diversification of investments in accordance with market risk factors have been included in the policy. Review how the insurer tracks performance of its different asset classes with a particular focus on market value volatility and losses/impairments.	Review recent performance and benchmark reports in comparison with the company's plan. Review the insurer's investment policy guidelines for appropriateness relating to market risks. Determine whether market risk management specific to high-risk investments is adequate by using an investment specialist. Use the I-Site+ insurer's Snapshot Investment Summary to identify high risk investments where the company's position is greater than average for its competitors in areas such as: • Bonds with call options and varied payment timing. • Foreign investments. • Hybrid capital securities. • Mezzanine loans. • Affiliated investments. • Residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), asset-backed securities

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				considered within the strategy. The insurer performs routine stress testing and/or scenario analysis that specifically takes into account recent and expected market value volatility by sector and industry in order to determine whether adjustments to the insurer's investment strategy are necessary. The insurer has its own process that is not solely dependent upon credit rating agencies to evaluate the creditworthiness of investment securities for investment purposes. The process is used prior to significant purchases and on an ongoing basis. The insurer's investment strategy considers the impact of, and market expectations for, climate change on different investments, and the investment policy includes guidelines that require diversification to protect against the impact of climate change.	Review the insurer's most recent stress testing/scenario analysis testing documentation to determine the adequacy of the insurer's analysis. Ensure inclusion of complex and volatile assets in investment policy, director review, stress testing, and asset liability matching. Review the insurer's investment policy and processes to understand the inputs into such decisions and the extent to which it requires credit analysis and is not solely reliant on credit rating agencies. Obtain evidence of the [illegible] process to research the quality of the investment. Review the company's investment strategy for consideration of climate change in different sectors and asset classes.	(ABS) CO/collateralized loan obligation (CLO) or similar bond collateral types. • Structured securities on negative watch. Perform stress testing/scenario analysis on the insurer's investment portfolio (by using an investment specialist if necessary) to identify potential solvency risks. Test the insurer's investments for compliance with its corporate strategy and investment policy guidelines. Consider use of an investment specialist to evaluate the company's exposure to climate change-related risk regarding its investment portfolio/strategy.

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
The board of directors (or committee thereof) and management may not effectively implement/enforce the investment policy/strategy.	OP T	Other	AIPS	The board of directors (or committee thereof) reviews and approves the insurer's investment policy on an annual basis with consideration of changing market conditions. The insurer monitors investments purchased, those sold, and what the investment holds. It also monitors compliance with the investment strategy that has been established by the board of directors (or committee thereof). This monitoring could be performed by senior management, an investment advisory board or internal auditors and is reported to the board of directors (or committee thereof). The board of directors (or committee thereof) receives a quarterly summary of the investment activity over the past quarter and reviews an analysis of current year vs. prior year results and budget to actual results, noting the impact of activity on the overall profile of the investment profile. This	Inspect documentation indicating the board of directors' (or committee thereof) approval of the insurer's investment policy on an annual basis. Consider the level of expertise in relation to the complexity of the company's investment strategy, as appropriate. Obtain a copy of the report that is used by the insurer to report investment policy compliance to the board of directors (or committee thereof), and verify the board's review of the investment activity. Verify that discussion of investments and performance took place at the quarterly board of directors (or committee thereof) meeting by reviewing the minutes. Perform an analytical review of the insurer's diversification of investments. For bonds, common stocks and	Review written policy for reasonableness. Obtain the underlying reports used by the board of directors (or committee thereof) to review the investment strategy results. Discuss with members of the board of directors (or committee thereof) to determine their level of involvement in the monitoring of the investment strategy/risks. Determine if there is sufficient focus on all relevant investment risks. Verify the underlying data included in the investment reports to senior management and the board of directors (or committee thereof). Perform an analytic comparing the investment characteristics of the portfolio with the written investment strategy. Determine whether the investment strategy is being met by the insurer.

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				should also take into account scheduled and unscheduled repayments.		preferred stocks, review the "Investment Material Holdings" Jumpstart report, and investigate report items.
The board of directors (or committee thereof) and management do not effectively monitor or supervise contracted third parties in the implementation of the investment policy/strategy. *See Section 1 Part III of the Handbook for additional guidance relevant to reviewing third-party investment advisers and associated contractual arrangements.	CR MK	Other	AIPS	Prior to entering into a contract with a third party, management reviews the third party's credentials to ensure that they are qualified to perform the service and verifies that no conflict of interest exists. Management ensures that third-party contracts include appropriate provisions and recognize fiduciary responsibility to the insurer. Contracts are reviewed for appropriate provisions related to: • Investment guidelines/selection. • Authority for transactions. • Reporting of transactions in sufficient detail and frequency. • Conflicts of interest. • Appropriateness of fees. • Review of performance. • Termination. The insurer monitors investments purchased, those sold, the performance of the investment portfolio	Review procedures that ensure management reviews the credentials, including confirming registration as investment advisor/manager, of the third party and that no conflict of interest exists. Verify the insurer control to ensure appropriate contract provisions. Specifically consider any situations and transactions where the potential of conflict of interest exists. This includes transactions with other accounts managed by the third-party manager, through brokers affiliated with the third-party manager, and investments in funds managed separately by the third-party manager. Obtain a copy of the report that is used by the insurer to report investment policy compliance to the board of directors (or committee	Assess the suitability of investment advisers through a review of information provided to the U.S. Securities and Exchange Commission (SEC) in Form ADV (if available) or other available information. Determine if there are any disciplinary actions or background information that might call into question the advisers' suitability for providing services rendered. Review significant investment advisory/management agreements for appropriate provisions. Review recent performance and benchmark reports in comparison with the company's plan. Test the insurer's investments for compliance with its investment policy guidelines. Assess significant changes in portfolio profile year over year and over the course of recent years to determine suitability of

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				against prior year or budgeted results, and what the insurer holds. It also monitors compliance with the investment strategy that has been established by the board of directors (or committee thereof). This monitoring can be performed by senior management, an investment advisory board or internal auditors and is reported to the board of directors (or committee thereof).	thereof), and verify the board's review of the investment activity. Verify that a discussion of investments took place at the board of directors (or committee thereof) meeting by reviewing a sample of meeting minutes.	changes for the company.
The insurer is not properly implementing and monitoring structured security transactions. **Please note**: If the company appears to have significant structured security holdings, consider requesting the completion of a Structured Security Exposure Report to assist in identifying and assessing risks in this area.	MK CR	Other	AIPS VIIA	The insurer has a plan in place that documents the following for its structured security portfolio: • Strategic objectives. • Relative to portfolios. • Senior management and board of directors (or committee thereof) oversight. • Major adverse factors and frequency of stress testing.	Determine whether management has adequately reviewed the insurer's non-agency structured security portfolio for the following risks: • Complex cash-flow structures (including interest-only and prepayment support structures). • Sub-prime borrowers within the underlying assets (e.g., mortgage loans, auto loans, credit cards, etc.). • Collateral type concentration. • Subordination in the overall structure of the transactions. • Trend analysis (underlying assets).	Validate the company's structured security assets were all included in the Structured Security Exposure Report, and determine whether reliance on them is appropriate in comparison to its products and other liabilities. If necessary, use an investment specialist to analyze the insurer's structured securities portfolio. Review a sample of structured securities to test for proper valuation.

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				Management reviews and considers prepayment volatility and cash-flow variability with regards to mortgage-backed securities in implementing its investment strategy. The insurer has a process in place to understand the reporting and valuation techniques discussed in SSAP No. 43R for complex structured securities.	Review the insurer's process to determine the valuation of complex structured securities.	
Investment returns are not sufficient to meet the risks assumed in the insurer's investment portfolio and the company's business strategy.	LQ CR MK ST	Other	ARPS	The insurer has a process in place in which its risk/reward strategy is reviewed on a regular basis. The scope of performed through the use of optimization models. The insurer prepares projections outlining expectations for specific asset classes, planned performance measures and benchmarks. Reports reflect performance during a set period of time along with a comparison to historical results, plan and benchmarks. The insurer has an established governance and reporting structure related to the evaluation of investment risk/reward within specific asset classes.	Gain an understanding of how the insurer reviews its risk/reward strategy. Test the controls over this process for operating effectiveness. Review the insurer's process to relate investment risk into its overall enterprise risk management (ERM) framework. Review the projections for specific asset classes and the asset performance reports and verify management oversight and approval. Review investment committee presentations, meeting minutes and portfolio reports related to the investment function. Determine whether	Test the data inputs used within the model(s) to ensure accurate information was utilized. Review assumptions used in model(s) for different risk factors (i.e., interest rate and volatility) for reasonableness. Review the appropriateness of the insurer's risk/reward strategy for investments, with the assistance of an investment specialist if necessary. Obtain industry data for peer companies, and compare asset class performance during a set period of time (i.e., benchmarking vs. industry data).

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				This includes frequent monitoring of investment returns considering specific asset class performance, and benchmarking to industry statistics is considered when evaluating investment returns. The company considers product guarantees and yield assumptions in both pricing and reserving in setting and updating its investment strategy.	management approves and reviews investment returns, considering specific asset classes, on a regular basis. Review the insurer's process to confirm if it is considering product guarantees and yield assumptions, as appropriate.	Compare the company's actual yield with guaranteed crediting rates, as well as with significant pricing and reserve assumptions to determine if investment spread is sufficient for ongoing operations.
The insurer is not properly implementing and monitoring derivative transactions.	MK CRST OP	Other	AIPS	The insurer has properly adopted a derivative use plan within the investment policy approved by the board of directors or which committee thereof, which includes the following attributes: • Management controls • Type and use limits • Relationship to overall investment limits. • Documentation and reporting requirements. • Valuation procedures. • Quantitative limits. • Risk management standards. • Compliance with applicable state law, internal policy and NAIC practices. • Margin requirements.	Review how management ensures that its derivative use plan is complete and in compliance with applicable laws and best practices. Determine whether the insurer's derivative traders are part of its larger risk-management department organization and not a profit center. Determine whether the company effectively implements its derivative strategy by performing walk-through with investment staff. Inquire to how they ensure that derivative agreements are in line with the strategy and objectives of the insurer.	Consider using an investment specialist to assist with detail test procedures. Review the insurer's derivative use policy guidelines for appropriateness. Perform a review of the insurer's derivative position to ensure it is in compliance with the hedging and replication strategies outlined in the derivative use plan. Select a sample of derivatives, and review the following attributes for compliance with the company's plan:

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				The insurer frequently reviews its derivative position to determine effectiveness of hedging and replication transactions and adjusts where necessary. The insurer periodically evaluates the financial condition and capabilities of its approved counterparties. Based on this review, the insurer sets and regularly reviews counterparty credit limits. Automated controls are in place to prevent the insurer from entering into a transaction with an unapproved counterparty, a transaction exceeding a counterparty's approved credit limit.	Review management control procedures for determining effectiveness of hedging and replication transactions for adequacy. Inspect documentation evidencing the insurer's review of its counterparties' financial condition and updates to credit limits that are based thereon. Observe automated controls that prevent transactions with unapproved counterparties or above a counterparty's credit limit. Observe limits to any override authority (may be verified through an information technology [IT] audit).	• Valuation. • Effectiveness. • Legal review. • Accounting compliance. • Maturity reasonableness (i.e., not long dated). Review hedge performance for periods of market volatility. Review the financial condition and capabilities of key counterparties of the insurer. Review a sample of collateral positions for compliance with limits. Validate compliance with the NAIC *List of Qualified U.S. Financial Institutions* available on the Securities Valuation Office's (SVO) web page.
The insurer is not properly implementing and monitoring security lending, repurchase and reverse repurchase transactions.	CR LQ OP	Other	AIPS LC	Insurer management implements controls over credit, market, and operational risk associated with securities operations, which include monitoring the following: • Percentage and type of securities permitted to be loaned. • Borrower (counterparty) concentration and	Review management's lending program and methods to compare it to actual operations. Determine how management ensures that the lending program complies with state laws, regulation, internal policy and NAIC practices. Review management controls for reinvestment of	Review guidelines for any securities lending programs deemed off balance sheet. Review maturity and duration of reinvested collateral in comparison to the stated term of the lending agreements and potential liquidity shortfalls individually by counterparty.

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				credit worthiness. • Amount of collateral and systematic true-up. • Investment of cash collateral. The insurer has established a securities lending framework based on its tolerance for market risks (including market price volatility and interest rate risk) and has included guidelines as to the internal approvals required to approve agreements, counterparty balances, programs and strategies.	collateral focusing on market value volatility and liquidity of the reinvested assets, and on the duration of the reinvested assets with the duration of the securities lending agreement. Evaluate the following internal procedures for adequacy: • Internal approvals. • Regulatory framework. • Contractual agreements. • Counterparty management. • Program size and composition. • Lending strategies. • Reinvestment strategies. • Risk measurements.	
The insurer may not effectively manage its asset duration to match its future liabilities.	LQ ST	Other	AIPS	The insurer has a process in place in which assets and liabilities are reviewed to ensure the insurer has enough cash inflows and assets convertible into cash to pay obligations. This should include consideration of call, extension and deferral (i.e., duration) of the assets, prepayment volatility of mortgage-backed securities liquidity and market value volatility. Actuaries document for investment staff the	Obtain documentation to evidence the insurer is reviewing the matching of assets and liabilities, and test for effectiveness as follows: • Verify the insurer has a process in place to determine the expected liability duration and to check the impact of any asset/liability mismatch. • Review maximum asset/liability mismatch duration allowed for reasonableness. • Verify asset data used for compliance of	Test the assumptions used in the asset and liability matching analysis. Determine whether the assumptions are reasonable based on overall economic and company historical and trend data, and validate that the company's illiquid assets (including private agreements, non-marketable fund investments, real estate related assets, special deposit restricted assets and affiliate investments) were all considered in its analysis.

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				duration of the liabilities through economic scenario testing. The company has a process in place to adjust its investment strategy to match the documented duration. The insurer has a governance structure that routinely challenges, approves and reviews the asset/liability matching activities of the insurer, taking into account recent and expected shifts in markets. The actuaries and investment staff meet regularly (e.g., monthly) to review asset and liability cash flows. Meetings discuss any large asset or liability cash flows expected, the durations of the in-force assets and liabilities, and the expected duration of new liabilities and asset purchases. Material hedge mismatches are investigated and remediated. Management monitors requirements for future commitments (including, but not limited to, collateral calls) to identify funding obligations that may be	policy. • Verify that the duration mismatches are not allowed to go outside of set parameters. Ensure that the company considers call, extension and deferral risk, and prepayment variability of mortgage-backed securities in its duration planning. Obtain documentation of the governance, and verify adequacy of reviews performed by management. Obtain documentation of the interaction between the investment staff and actuaries to ensure it is thorough and timely considering the size and complexity of the company's portfolio. In addition, verify that identified mismatches are appropriately remediated by the company. Review procedures to track funding commitments under different market conditions.	Verify underlying data used to analyze the matching of assets and liabilities using the pricing documents showing liability durations, and the Actuarial Opinion Memorandum showing asset and liability cash flows. If necessary, use an investment specialist and/or actuary to analyze the insurer's asset/liability matching. Review asset and liability cash flows to determine how hedging affected asset liability matching. Trace material mismatches to appropriate communication. Review a sample of significant transactions to determine if all funding commitments have been appropriately identified.

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				required under different market conditions.		
The insurer does not review its liquidity position to determine if adjustments are necessary to meet its potential near-term cash flow needs. **Please Note**: Examiners may wish to refer to the Exam Planning Questionnaire section on liquidity (Exhibit B, Section IV, Part J) to assist in identifying and assessing potential risk in this area.	QR ST LQ	Other	LC	The insurer has a liquidity measurement, monitoring and management framework that includes a written liquidity plan with contingency and stress-testing features.	Determine whether management's review of the liquidity plan and stress testing procedures and assumptions is reasonable considering its experience and market history.	Validate that the company's illiquid assets (including private placement, non-marketable funds, real estate-related assets, special deposits/restricted assets and affiliate investments) were all considered, and determine whether it relies heavily upon nontraditional or non-insurance activities (e.g., commercial paper and securities lending) for liquidity. Validate company liquidity testing to confirm results under stressed scenarios. If necessary, use an investment specialist and/or actuary to analyze the insurer's liquidity position.
Financial Reporting Risks						
The insurer's bonds, stocks and short-term investments that are considered hard-to-value, high-risk and/or subject to significant price variation are incorrectly valued.	MK	VA	VIIA	The insurer reconciles its investments to the statements received from its investment managers/custodians on a regular basis. In the event the insurer manages its own investments, it obtains pricing information from a recognized independent source, such as Bloomberg.	Inquire regarding reconciliations of the insurer's recorded investments to the investment statements received from investment managers/custodians. Test the controls in place surrounding the independent pricing process to determine whether guidelines (mid-market, bid, ask) are reasonable and	Review Jumpstart investment exception reports to determine whether the company's quality assurance controls are functioning for accurate Committee on Uniform Security Identification Procedures (CUSIP), designation and market values. Confirm the value of

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				The insurer periodically reviews the prepayment and default assumptions for loan-backed securities and evaluates the proper valuation per SSAP No. 43R. The insurer has procedures in place to review for wash sales and to determine whether they have been properly valued and disclosed in accordance with SSAP No. 103R. The insurer has a process in place to ensure the correct currency conversion is used in accordance with SSAP No. 23. If investment transaction services are outsourced, the insurer either audits the performance of its service providers on a regular basis or obtains and reviews a Service Organization Control (SOC) 1 report on a regular basis.	consistently applied. Review the insurer's process to review prepayment assumptions for loan-backed securities, and inspect relevant documents as necessary. Review the insurer's procedures for identifying wash sales, including its listing of such sales. Ensure that this list is updated at least on a quarterly basis and is properly reviewed by the insurer. Discuss with management the process used to ensure correct currency conversions are in place. Test the process to determine whether these processes are reasonable and operating as intended. Obtain and review the insurer's audit reports of its service providers' available SOC 1 Type II reports from investment managers/custodians, and review for evidence of periodic managerial review.	securities with investment managers/custodians, and agree the amount confirmed to the insurer's records. Select a sample of pricing of securities, and verify quotes with other independent sources. Review insurer assumptions for reasonableness. Review the insurer's investment transactions to test the completeness of the insurer's listing of wash sales. If wash sales are identified, determine whether they have been properly valued and disclosed in accordance with SSAP No. 103R. Select a sample from the insurer's wash sale listing and determine whether they have been properly valued and disclosed in accordance with SSAP No. 103R.* Select a sample in which a currency conversion was used, independently price the conversion factor, and compare with the insurer's calculation.
The insurer may not properly write down the value of securities	CR LQ	VA PD	VIIA	The insurer has a process in place to monitor potentially impaired securities.	Verify that the insurer has a watch list. Review and ensure it has been reviewed	Test the insurer's watch list for completeness. Review Schedules B, D and BA for

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
that are other than temporarily impaired.				Potential impairments are identified on a watch list to provide a heightened level of management oversight. Written policies and procedures provide guidance to determine other-than-temporarily impaired (OTTI) securities. The insurer's policy should follow the appropriate guidance (statutory accounting principles [SAP] or generally accepted accounting principles [GAAP]). The insurer has a policy in place to ensure impairments (OTTI and permanent) are written down on a timely manner and disclosed, as appropriate, under SAP or GAAP. Insurer management receives regular communication on impairments from asset management.	by management. Inquire as to how often the list is updated. Verify that the insurer is aware of the OTTI guidance and what the suggested triggers are. Verify that triggers are consistent with applicable SAP and GAAP reporting. Test the operating effectiveness of the OTTI triggers. Review the insurer's policy, and determine whether it is operating effectively. Review the asset manager's process for communicating impairments	potentially impaired securities. Review downgraded securities and investments with substantial differences between amortized cost and fair value to identify potentially impaired securities. Review the insurer's classification of impairment, and determine whether the classification is appropriate. Review supporting documentation of write-downs posted in the appropriate time period.
The investments in high-risk mortgage loans are incorrectly valued.	CR LQ MK	VA CO	VIIA	The insurer has designated personnel who review the adjusted loan-to-value (ALTV) and debt service coverage ratio (DSC), amortization of discount or premium and impairment. The personnel would also identify any loans in	Discuss with management how it monitors the valuation and amortization of mortgage loans. Review the documentation relating to the valuation process to test whether the process is operating effectively.	Obtain a listing of mortgage loans. Select a sample, and recalculate the valuation of the loan, as well as the amount of premium. For a sample of outstanding loans, review documentation on loan-to-

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				default/being foreclosed. The insurer has a process in place to ensure that any prepayments of principal and interest are properly recorded in accordance with SSAP No. 37. The insurer has a process in place to ensure that due and accrued interest that is 180 days past due and collectible is non-admitted. The [illegible] also ensures that interest [illegible] 180 days past due and not collectible is written off in accordance with [illegible] No. 37. Current appraisals are maintained by the insurer.	Discuss with management how prepayments are recorded. Determine whether the process is appropriate and operating effectively. Discuss with management how due and accrued interest is monitored. Determine whether due and accrued interest is analyzed on a quarterly basis to ensure proper treatment in accordance with SSAP No. 37. Obtain and inspect the schedule of due and accrued interest to determine whether the process is operating effectively. Obtain the master schedule [illegible] when appraisals [illegible] to be updated for each mortgage loan the insurer holds [illegible] investment (in accordance with SSAP No. 37). Ensure that this schedule is monitored and updated prior to when the latest appraisal comes due.	value, based on updated value estimates since the last appraisal, debt service coverage ratios and rent rolls on the underlying properties. Obtain a schedule of prepayments. Recalculate and test that the prepayments are recorded in accordance with SSAP No. 37. Obtain a schedule of mortgage loans and the accrued interest over 180 days past due. Ensure the listing is complete. Select a sample of mortgage loans, and recalculate the days past due for accuracy. Take the total 180 days past due report, and agree it to the amount written off within the balance sheet. Obtain a master schedule of appraisal dates. Select a sample of mortgages to test and ensure the most current appraisal has been obtained and recorded within the [illegible]. Ensure that a sample of the insurer's appraisers have a Member Appraisal Institute (MAI) certification or equivalent appraiser

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
						certifications, as applicable.*
The insurer is not properly identifying, handling and recording foreclosed mortgage loans.	CR MK LQ	AC CO VA PD	VIIA	The insurer has a process in place to identify loans in default and foreclose on the loans appropriately. The insurer has a process in place to ensure the impairments are recorded in accordance with SSAP No. 37.	Obtain an understanding of the insurer's process to identify loans in default and foreclose appropriately. Test the operating effectiveness of this process by inspecting the respective documents. Obtain an understanding of the process to record impairments. Test the operating effectiveness.	Compare loans with high adjusted loan-to-values and/or low debt service coverage ratios with the insurer's listing of loans in default for accuracy and completeness. Obtain a listing of foreclosed mortgage loans. Review management's calculations resulting from impairments to mortgage loans for appropriateness. Trace and agree the amount to the annual statement.
The insurer's investments in joint ventures, partnerships and limited liability companies are incorrectly valued.	MK	VA	VIIA	The insurer has a process in place to record investments using the statutory equity method in accordance with SSAP No. 48. For minority ownership interests (less than 10%), the insurer has a process in place to record investments using the audited GAAP equity method, also in accordance with SSAP No. 48. The insurer has a process in place to determine the correct ownership percentage of its joint ventures, investments in partnerships and limited liability companies.	Review the insurer's process to record investments in joint ventures, limited liability companies and partnerships. Determine whether the process is operating effectively and in accordance with SSAP No. 48 guidance. Review the insurer's process of reporting and calculating investments at the correct ownership percentage. Ensure the process is operating effectively.	Review cash flows received from the investments, and compare with expected returns. Obtain a listing of joint ventures, limited liability companies and partnerships. Select a sample and test the following: • Valued in accordance with SSAP No. 48. • Completely reported, including commitments for additional funding requirements on the investment schedules and notes. • Supported by investment reports that are audited and are documented in detail

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
						and complete. • Calculations of income versus gains and losses are accurately reported in investment schedules and notes. • Obtain an independent statement that confirms the insurer's ownership percentage. Ensure the confirmed percentage amount agrees to the insurer's stated percentage.
The value and presentation of loaned securities, repurchase and reverse repurchase agreements are incorrect.	OP MK	VA PD	MA	The insurer has a process in place to ensure that the collateral is properly valued and maintained at the appropriate level. The value of the collateral is maintained at or greater than 102% of the market value of the loaned securities or 95% of the market value of repurchase agreements. The collateral is not restricted, and the insurer follows the accounting treatment outlined in SSAP No. 103R.	Test the insurer's process in place to ensure collateral is held at or more than 102% for each loaned security for operating effectiveness or 95% of the market value of repurchase agreements. Test the insurer's controls regarding compliance with SSAP No. 103R.	Test a sample of the collateral balances (through confirmation or review of collections) to ensure that they are maintained at or more than 102% of the market value of the loaned securities.* For the same sample selection, test to ensure the securities are not restricted.* Based on the results of the testing above, determine whether the insurer is applying the correct accounting treatment in accordance with SSAP No. 103R. Validate that investment securities are in compliance with state laws, regulation, internal policy and NAIC practices.

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
						Review a sample of netting agreements by counterparty, positive vs. negative positions (i.e., amounts due versus amounts owed) and collateral pledged vs. collateral held to ensure appropriate accounting.
The insurer is not properly evaluating, valuing and recording derivative transactions.	CR MK OP ST	AC VA C PD	VIIA	Management reviews derivative reports in a timely manner to ensure compliance with its current accounting practices and procedures. As such, management ensures that derivatives are accurately and completely recorded in compliance with SSAP No. 86, internal policy and state law. Management implements controls as follows: • Mandatory trader vacation policy. • Review of gross trading positions. • Monitor any cancel & correct, as-of, amendment and off-market transactions. • Monitor trades done with unspecified counterparties and unconfirmed and unmatched trades. • Reports of market risk profit and loss look-	Confirm management uses control best practices and it includes review of the derivative valuation process, especially for over-the-counter derivatives to ensure that it is robust and transparent for derivatives that have no published daily exchange price. Ensure that it includes all derivatives that have unusual or complex terms. Ensure there is a segregation as follows: • Traders do not have access to financial reporting or trade clearance functions. • Insurer and third-party funds. • Ensure that company has adequate reporting capabilities for testing compliance with limits and policies.	Review Schedule DB to ensure it is accurate and complete, including the following attributes: • Trades are recorded shortly after the trade is made. • Financial results of the trade are accurately reported. Select a sample of open derivative transactions, and confirm them directly with counterparties. If necessary, use an investment specialist to analyze and/or value the insurer's derivative holdings. Review compliance with limits and policies for a sample of reporting dates. Recalculate collateral requirements based upon the terms of derivative contracts and periodic valuation of open positions. Trace collateral transfers to

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				backs. • Treasury review of derivative activity. • Reports compliance with derivative use plan, statutory limits and policies on a timely basis. The insurer has implemented controls over the maintenance of collateral associated with open derivative positions.	Review processes and controls over the determination and recording of collateral received from or to counterparties to mitigate the risk of counterparty credit exposure.	statements or other correspondence from or to counterparties. Review and consider gross and net exposures with counterparties.
The insurer is not properly valuing investments in subsidiary, controlled and affiliated (SCA) entities.	MK LQ	PD AC VA	RPHCC	The insurer has procedures in place to value its investments in SCA entities to ensure compliance with the requirements of SSAP No. 97.	Review valuation procedures for investments in SCA entities to ensure that the investments are properly valued.	Perform a review of investments in SCA entities to ensure they meet the requirements of SSAP No. 97.

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EXAMINATION REPOSITORY – REINSURANCE (ASSUMING INSURER)

Annual Statement Blank Line Items

Listed below are the corresponding Annual Statement line items that are related to the identified risks contained in this exam repository:

Reinsurance Payable on Paid Loss and Loss Adjustment Expenses
Funds Held by the Company Under Reinsurance Treaties
Contract Liabilities Not Included Elsewhere – Other Amounts Payable on Reinsurance
Commissions and Expense Allowances Payable on Reinsurance Assumed

Relevant Statements of Statutory Accounting Principles (SSAPs)

All of the relevant SSAPs related to the reinsurance process, regardless of whether or not the corresponding risks are included within this exam repository, are listed below:

No. 5R Liabilities, Contingencies and Impairments of Assets – Revised
No. 6 Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due from Agents and Brokers
No. 25 Affiliates and Other Related Parties
No. 61R Life, Deposit-Type and Accident and Health Reinsurance – Revised
No. 62R Property and Casualty Reinsurance – Revised
No. 63 Underwriting Pools
No. 64 Offsetting and Netting of Assets and Liabilities
No. 65 Property and Casualty Contracts

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
Other Than Financial Reporting Risks						
The (re)insurer does not have or does not comply with its reinsurance strategy.	OP ST	Other	UPSQ	The (re)insurer has a documented strategy that indicates the type of reinsurance to be offered and the guidelines for ceding companies to meet, which is approved by the board of directors (or committee thereof). The (re)insurer has a formal process in place to review and approve reinsurance agreements for compliance with the company's documented strategy.	Review meeting minutes of the board of directors (or committee thereof) or other evidence of board involvement in the approval of the (re)insurer's reinsurance strategy. Obtain and review documented reinsurance strategy. Select a sample of new reinsurance contracts for evidence of review and approval in accordance with the insurer's process.	Review assuming agreements to determine whether the lines, types and limits of business assumed conform to the (re)insurer's reinsurance strategy.
The (re)insurer is not properly evaluating and monitoring the ceding insurer for compliance with guidelines outlined in the reinsurance strategy.	OP	Other	UPSQ	Prior to entering into contracts, the (re)insurer performs due diligence on the potential ceding insurers to ensure compliance with the reinsurer's underwriting and claims practices. Throughout the term of the contract, the (re)insurer periodically reviews the underwriting practices and evaluates the underwriting and claims results of ceding insurers through analytical reviews and/or quality assurance (QA) reviews.	Obtain documentation of the (re)insurer's due diligence and consider whether the work completed is appropriate. Obtain documentation of the (re)insurer's periodic reviews of ceding insurers.	Review analytically the results of ceding insurers to evaluate their underwriting and claims practices.
The (re)insurer does not collect accurate and complete loss exposure data from	OP ST	Other	UPSQ AARP RD	The (re)insurer has a process in place to review and accumulate loss exposure data reported by	Review and test the operating effectiveness of the (re)insurer's processes to review and accumulate	Analytically review the loss exposure data reported by ceding insurers/brokers to identify potential

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
ceding insurers/brokers. (See also Examination Repository – Reserves/Claims Handling.)				its ceding insurer/brokers. • The process includes consistency checks/variance analysis in reviewing reported data; and • The (re)insurer conducts periodic audits of ceding companies to review reported loss exposure data and other significant reporting elements.	loss exposure data reported by ceding insurers/brokers.	inconsistencies. If deemed necessary, perform additional procedures to get comfort with the loss exposure data reported to the (re)insurer from ceding insurers/brokers.
The (re)insurer has not established and maintained appropriate risk exposure limits for assuming reinsurance.	OP ST	Other	UPSQ	The (re)insurer has established and documented risk exposure limits by geography and/or line of business that have been reviewed and approved by senior management. The (re)insurer utilizes adequately staffed, well-qualified reinsurance department(s) that has experience in all lines of business and geographic locations served by the (re)insurer. The (re)insurer accumulates assumed loss exposure data and utilizes data models to track compliance with exposure limits established by the (re)insurer.	Review documentation of risk exposure limits and evidence of senior management review/approval. Review the credentials, background and responsibilities of the senior person managing the reinsurance function. Test the operating effectiveness of the (re)insurer's controls to accumulate loss exposure data and track compliance with the exposure limits by reviewing the modeling process.	If necessary, recalculate the aggregate loss exposures by reviewing data reported by ceding insurers/brokers. Utilize audit software to review the (re)insurer's risk exposures (e.g., summarize policies by ZIP code, industry code, policy size, etc.) for compliance with insurer limits. If the (re)insurer has not identified risk exposure limits, test the risk exposures for appropriateness by considering industry standards.
The (re)insurer is not monitoring financial results for financially	OP ST	Other	UPSQ	The (re)insurer has procedures in place governing comparison of	Obtain documentation of ongoing monitoring of reinsurance results.	Review treaty files for evidence of ongoing review process.

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
significant assume contracts.				actual vs. expected for financially significant contracts.		Perform analytical procedures to ensure that significant contracts do not represent a future solvency risk.
The (re)insurer does not effectively oversee its reinsurance intermediaries to ensure that they are complying with the intermediary agreement.	OP CP	Other	UPSQ	The reinsurer has a written agreement with the intermediary to document the responsibilities of each party. The (re)insurer periodically reviews the processes, procedures and transactions performed by the intermediary to ensure that they are properly negotiating contracts and fulfilling other contractual duties as outlined in the agreement.	Review the documentation that provides evidence that a written contract is received and approved. Review documentation that provides evidence of periodic review of the intermediary function.	Review the results of audits performed by the intermediaries (audits of ceding insurers). If deemed necessary, perform a site visit to audit the intermediary's processes and transactions.
Financial Reporting Risks						
Reinsurance contracts are not completed and accounted for in compliance with statutory accounting principles (SAP) and applicable state requirements.	LG	PD EX OB/OW	RRC	The reinsurer evaluates all reinsurance contracts to ensure that there is adequate transfer of risk in compliance with SAP. Contracts are reviewed to ensure inclusion of adequate collateral and contract provisions as required by SAP. All reinsurance contracts are reviewed by the reinsurer's legal department to ensure that there are no provisions that might adversely affect the	Gain an understanding of the (re)insurer's processes for the review of reinsurance contracts and examine contracts for evidence of evaluation. • For P&C insurers, review the insurer's policies and procedures in place to 1) determine how the reinsurance agreement is accounted for (prospective, retroactively or deposited in accordance with SSAP No. 62R); and 2) ensure the	For all significant contracts, determine whether the contracts include appropriate clauses and transfer risk in accordance with SAP. Use Exhibit N, Part Three to assist in this process. If a contract does not transfer risk, verify that it has received deposit accounting treatment in accordance with SAP.* For a sample of P&C reinsurance contracts, determine whether the

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				assuming insurer. The assuming insurer has procedures in place to ensure that reinsurance contracts are finalized, reduced to written form and signed in accordance with applicable SSAPs. • For P&C insurers, contracts must be executed within nine months of effective date or accounted for as [illegible] agreements in accordance with SSAP No. 62R. • For life insurers, credit [illegible] is not authorized if the agreement, amendment or binding letter of intent is not executed by both parties by the "as of" date of the financial statement in accordance with Appendix A-791.	agreement includes required agreement terms. • For life insurers, review the insurer's policies and procedures in place to ensure compliance with Appendix A-791.	execution date falls within nine months of the effective date or that the contract is accounted for retroactively in accordance with SSAP No. 62R. For a sample of life reinsurance contracts, determine whether the effective date and the execution date fall within Appendix A-791 requirements.
The (re)insurer is not including all assumed contracts in its financial statements.	OP RV	AC CO PD	RD RRC	The (re)insurer has procedures in place that define the specific authority levels of designated personnel who are authorized to commit the corporation to new reinsurance contracts. The (re)insurer has written guidelines/procedures specifying acceptable documentation, review and	Review a selection of contracts to: • Ensure that only authorized personnel are committing the insurer to reinsurance contracts. • Ensure that the appropriate documentation and approvals are in place. • Determine whether they have been reviewed by	Utilize NAIC Examination Jumpstart reports to identify instances where material assumed reinsurance liabilities have not been recorded in the assuming insurer's financial statement.

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				approval required before a contract may be accepted. The (re)insurer has procedures in place to ensure review of all contracts by the accounting department to ensure proper reporting.	the accounting department for purposes of determining the proper accounting treatment.	
Reinsurance contracts with affiliates have not been filed in accordance with applicable state statutes and do not have equitable contract provisions.	OP ST	C AC	A RP RI HCC	The (re)insurer has policies and procedures in place to ensure all contracts with affiliates are filed with the department as required by applicable statutes (Form D filing). The (re)insurer has policies in place to ensure all contracts with affiliates are negotiated at arm's length and are in accordance with SAP. These policies ensure that: • Contracts are subject to review and approval by senior management; • Ceding commissions are commensurate with the nature/quality of the business assumed; • Contract terms comply with SSAP No. 25; • Reinsurance is not being used to transfer capital to affiliates; and • Actuarial review is performed prior to	Review the insurer's policies and procedures in place to ensure such policies adhere to applicable statutes and would adequately identify transactions requiring a filing. Test the (re)insurer's processes to ensure that transactions with related parties are negotiated at arm's length by obtaining evidence of senior management review and approval and support for the appropriateness of ceding commissions, risk transfer and adequate pricing.	Obtain and review the significant contracts between the (re)insurer and its affiliates and ensure that agreements are filed with the insurance department in accordance with applicable state requirements. Verify that the (re)insurer is operating in accordance with approved contract terms. Review contract provisions for reasonableness through conducting analytical procedures such as reviewing the profitability of business assumed from affiliates and/or comparing commissions paid to the ceding insurer's expense [illegible] or comparing actual to expected results. Consider involving a reinsurance expert or actuarial examiner to review complex contracts and/or those with questionable

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				contract execution to ensure that policies are enforced.		provisions. Consider performing independent testing to evaluate the reasonableness of contract pricing and terms.

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EXAMINATION REPOSITORY – REINSURANCE (CEDING INSURER)

Annual Statement Blank Line Items

Listed below are the corresponding Annual Statement line items that are related to the identified risks contained in this exam repository:

Amounts Recoverable from Reinsurers
Funds Held by or Deposited with Reinsured Companies
Other Amounts Receivable Under Reinsurance Contracts
Ceded Reinsurance Premiums Payable (Net of Ceding Commissions)
Funds Held by Company Under Reinsurance Treaties *(P&C Companies)*
Funds Held Under Reinsurance Treaties with Unauthorized Reinsurers *(Life Companies)*
Provision for Reinsurance
Contract Liabilities Not Included Elsewhere – Other Amounts Payable on Reinsurance
Miscellaneous Liabilities – Reinsurance in Unauthorized Companies (*Life Companies*)
Funds Held Under Coinsurance *(Life Companies)*

Relevant Statements of Statutory Accounting Principles (SSAPs)

All of the relevant SSAPs related to the reinsurance process, regardless of whether or not the corresponding risks are included within this exam repository, are listed below:

No. 5R Liabilities, Contingencies and Impairments of Assets – Revised
No. 25 Affiliates and Other Related Parties
No. 61R Life, Deposit-Type and Accident and Health Reinsurance – Revised (*Health/Life Companies*)
No. 62R Property and Casualty Reinsurance – Revised (*P&C Companies*)
No. 63 Underwriting Pools (*Health/Life Companies*)
No. 64 Offsetting and Netting of Assets and Liabilities
No. 65 Property and Casualty Contracts (*P&C Companies*)

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
Other Than Financial Reporting Risks						
The insurer does not accurately identify, accumulate and track its aggregate loss exposures that may require reinsurance coverage.	ST OP	Other	AARP	The insurer has a risk management function in place to identify, track and monitor various loss exposures (e.g., catastrophic risk, mortality, morbidity, epidemic, etc.). The insurer has processes in place to ensure that policy information is correctly captured in the system (See also Examination Repository – Underwriting). (Note: This function may be outsourced to a TPA/MGA). The insurer has a process in place to review and accumulate loss exposure data reported by its ceding insurers/brokers for inclusion in tracking aggregate loss exposure (See also Examination Repository – Reinsurance Assumed). If this process is outsourced to a third-party administrator (TPA) or managing general agent (MGA), the insurer has a process in place to ensure that the TPA/MGA correctly inputs data into the system.	Review and test the operating effectiveness of the insurer's processes to identify, track and monitor relevant loss exposures. Test controls relating to the accuracy of policy data uploaded (by the insurer or a TPA/MGA) to the system (See also Examination Repository – Underwriting). Review and test the operating effectiveness of the (re)insurer's processes to review and accumulate loss exposure data reported by ceding insurers/brokers (See also Examination Repository – Reinsurance Assumed).	Select a sample of directly underwritten policies to verify that the insurer has correctly recorded loss exposure data associated with relevant policies (See also Examination Repository – Underwriting). Analytically review the loss exposure data reported to the company by ceding insurers/brokers on assumed business to identify potential inconsistencies (See also Examination Repository – Reinsurance Assumed). If deemed necessary, perform additional procedures to get comfort with the loss exposure data reported to the (re)insurer from ceding insurers/brokers on assumed business (See also Examination Repository – Reinsurance Assumed).
The insurer has not established and	ST OP	Other	AARP	The insurer has a well-defined reinsurance strategy	Review meeting minutes of the board of directors (or a	Review the insurer's reinsurance levels for

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
maintained appropriate reinsurance levels in accordance with the company's capital level, loss exposures and underwriting risk profile.				that is based on the aggregate loss exposures it faces. The strategy indicates the type of reinsurance (e.g., aggregate excess of loss, per occurrence, etc.) to be maintained by the organization and is approved by the board of directors (or a committee thereof). The insurer has established and documented exposure limits and risk appetite that have been reviewed and approved by senior management. The insurer reinsures all exposures that exceed the exposure limits and maintains coverage in accordance with its risk appetite. The insurer has developed formal documentation of its reinsurance structure and has established an effective, ongoing dialogue among the underwriting, claims and reinsurance areas. The insurer has a process in place to evaluate the effectiveness of its reinsurance coverage.	committee thereof) or other evidence of board involvement in the approval of the insurer's reinsurance policy. Review how aggregated/modeled loss exposure data is utilized by the company to reach reinsurance decisions. Review documentation of reinsurance coverage limits and evidence of senior management review/approval. Review a summary of all reinsurance contracts to ensure that the coverages match the insurer's exposure limits. Review evidence of interaction between the underwriting, claims and reinsurance areas. Review the insurer's analysis of results gross and net of reinsurance.	appropriateness. Consider the results of data aggregation/ models to assist in this assessment. Review the insurer's reinsurance coverage as compared to the risk being retained by the insurer to ensure adequate, but not excessive, reinsurance levels. Calculate the historical aggregate profitability of reinsurance. Consider applying a range of scenarios to a selection of significant reinsurance contracts to test the overall performance/prospective profitability of the contract and to assess whether the ceding commission is greater than the cost to write the business. Review reinsurance contracts to determine if risk-limiting provisions (e.g., sliding commissions, loss corridors, etc.) impact the effectiveness of the insurer's reinsurance strategy.

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				The insurer performs a cost/benefit analysis prior to entering into reinsurance agreements.	Review the insurer's cost/benefit analysis.	
The insurer's catastrophic reinsurance protections are inadequate.	ST OP	Other	AARP	The insurer uses one of the industry's catastrophic modeling software tools (RMS, AIR, EQECAT, etc.) to determine the probable maximum loss (PML) by zone. The process includes actuarial involvement with the ceded reinsurance department to insure the cession to third party reinsurers purchases the proper amount of reinsurance.	Review the adequacy of the process and tools utilized to determine the insurer's PML amount(s). Determine whether the insured's reinsurance strategy includes the involvement of the actuarial and ceded reinsurance departments in the purchasing of catastrophic reinsurance.	Review the reasonableness of the catastrophic reinsurance coverage in place at the insurer by benchmarking against competitors and/or comparing against industry standards. Consider involving an exam actuary or reinsurance specialist in assessing the adequacy of the insurer's catastrophic reinsurance coverage.
				The insurer adjusts its retentions or uses reinsurance alternatives, such as cat bonds, to ensure full placement at each catastrophic layer. The insurer has protected itself against multiple occurrences in the same period with contractual reinstatement of coverage.	Review the coverages in place for each layer of insurance for appropriate supervisory review. Determine whether the insurer's reinsurance strategy requires premium reinstatement for the catastrophic program.	
The insurer is over-exposed to credit and liquidity risks in its use of reinsurance counterparties.	OP ST CR LQ	Other	AARP	The insurer has policies in place requiring utilization of multiple reinsurers to reduce concentration with any one entity.	Test the operating effectiveness of the insurer's controls to track compliance with the concentration policy.	Based on a review of significant contracts, determine whether the insurer is properly diversified.

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				The insurer has developed a formal process to approve reinsurance counterparties. The insurer has a process in place to preapprove and set maximum limits to be ceded to reinsurers that are monitored and revised, as necessary. The insurer continually monitors the financial solvency of its reinsurers throughout the duration of the reinsurance contracts. Collateral is held in association with significant treaties to encourage prompt settlement and fulfillment of obligations.	Obtain evidence of the company's process to approve reinsurance counterparties. Obtain evidence of the preapproval process and documentation of maximum reinsurance limits. Obtain evidence of the insurer's ongoing review of its reinsurers. Obtain evidence of the insurer's process to consider/require collateral to be held for significant treaties.	Perform procedures to evaluate the quality of significant reinsurers utilized by the insurer; for example: • Review agency ratings • Review financial results Contact domestic regulator regarding any concerns For select reinsurers, verify that the balance currently ceded is within the maximum limits set by the insurer.
Smaller, less complex or new insurers are unable to negotiate equitable reinsurance contract terms from larger or more experienced reinsurers.	OP ST LQ	Other	AARP	The insurer engages licensed reinsurance intermediaries to negotiate fair and accurate reinsurance contracts on its behalf.	Review the work performed by the insurer to determine whether the intermediary is licensed.	Review the credentials, background and experience of those negotiating the contracts to ensure that they are licensed to represent the insurer in contract negotiations.
Financial Reporting Risks						
Reinsurance contracts with affiliates have not been filed in accordance with applicable state statutes and do not include equitable	OP ST	CM AC	AARP RPHCC	The insurer has policies and procedures in place to ensure all contracts with affiliates are filed with the insurance department as required by applicable state statutes (Form D filing).	Review the insurer's policies and procedures in place to ensure such policies adhere to applicable statutes and would adequately identify transactions requiring a filing.	Obtain and review the significant contracts between the insurer and its affiliates and ensure that agreements are filed with the insurance department in accordance with applicable

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
contract provisions				The insurer has policies in place to ensure that all contracts with affiliates are negotiated at arm's length and are in accordance with statutory accounting principles (SAP). These policies ensure that: • Contracts are subject to review and approval by senior management; • Ceding commissions are sufficient to cover the insurer's underwriting expenses. Contract terms comply with statutory SAP No.25; • Reinsurance is not being used to transfer capital to affiliates; and • Actuarial review is performed prior to contract execution to ensure that policies are enforced. The insurer has policies in place to ensure multiple cedent contracts have fair and equitable allocation terms and are subject to review and approval by all impacted divisions (e.g., accounting, actuarial, etc.).	Test the insurer's process to ensure that transactions with related parties are negotiated at arm's length by obtaining evidence of senior management review and approval and support for the sufficiency of ceding commissions, risk transfer and adequate pricing. Evaluate procedures in place for multiple cedent arrangements have allocation terms in place (including cost allocation agreements when appropriate), and that such terms are fair and equitable and applicable to underlying reinsurance agreement.	state requirements. Verify that the insurer is operating in accordance with approved contract terms. Review contract provisions for reasonableness through conducting analytical procedures such as comparing ceding commissions to the insurer's expense ratio or comparing actual to expected results. Consider involving a reinsurance expert or actuarial examiner to review complex contracts and/or those with questionable provisions. Consider performing independent testing to evaluate the reasonableness of contract pricing and terms. Review significant multiple cedent agreements to ensure allocation terms and agreements are clearly documented and equitable.
Reinsurance contracts are not completed and accounted for in	OP	PD EX OB/OW	RRC	The insurer evaluates all reinsurance contracts to ensure that there is adequate	Examine contracts for evidence of insurer evaluation and review for	Obtain copies of all significant reinsurance contracts in-force and

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
compliance with SAP and applicable state requirements.		VA		transfer of risk, in compliance with SAP. Contracts are reviewed to ensure inclusion of adequate collateral and contract provisions as required by SAP. All reinsurance contracts are reviewed by the insurer's legal department to ensure that there are no provisions that might adversely affect the insurer. The insurer has policies in place to ensure that reinsurance contracts are finalized, reduced to written form and signed in accordance with applicable SSAPs. • For P&C insurers, contracts must be executed within nine months of effective date or accounted for as retroactive agreements in accordance with SSAP No. 62R. • For life insurers, credit for reinsurance is not authorized if the agreement, amendment or binding letter of intent is not executed by both parties by the "as-of" date of the financial statement in	all required regulatory elements. • For P&C insurers, review the insurer's policies and procedures in place to 1) determine how the reinsurance agreement is accounted for (prospective, retroactively or deposited in accordance with SSAP No. 62R); and 2) ensure the agreement includes required agreement terms. • For life insurers, review the insurer's policies and procedures in place to ensure compliance with Appendix A-791.	complete Exhibit N, Part Three, to ensure transfer of risk. If a contract does not transfer risk, verify whether it has received deposit accounting treatment in accordance with SAP. Obtain copies of all significant reinsurance contracts in-force for the period under examination. Determine whether the contract includes effective date and execution date, payment terms, termination clause, insolvency clause, policies/lines of business reinsured, insurer retention, etc. For a sample of P&C reinsurance contracts, determine whether the effective date and the execution date fall within nine months of each other or that the contract is accounted for retroactively in accordance with SSAP No. 62R.* For a sample of life insurance contracts, determine whether the effective date and execution date meet Appendix A-791 requirements.*

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				accordance with Appendix A-791.		
The insurer is not accurately billing or recording loss and loss adjustment expense (LAE) payments for policies linked to reinsurance contracts.	OP LO	EX CO AC	RRC	The insurer has procedures in place whereby policies meeting reinsurance contract criteria are automatically attached to the applicable reinsurance contract. When a claim is filed on a tagged policy, the system notifies the user so that the claim can be subjected to the reinsurance process. When claims are paid that are covered under a reinsurance policy, a billing is automatically generated with all of the relevant claim information required by the reinsurer and a corresponding recoverable amount is recorded. The insurer has procedures in place whereby timely notice is provided to the reinsurer in accordance with reporting requirements (e.g., reported claims in excess of 50% of retention, death or dismemberment). Records associated with reinsurance recoverable balances are appropriately restricted, conform to standards outlined in the reinsurance treaty and	Test the operating effectiveness of the identification and billing of reinsurance recoverable balances through reperformance and observation. Test the operating effectiveness of controls over the reinsurance recordkeeping process by observing access restrictions and inspecting documents	Perform procedures related to the NAIC Examination Jumpstart approach to test whether the level of ceded recoverables are reasonably equivalent to the level of assumed liabilities reported by the assuming reinsurers. Verify whether the ceding insurer has paid the claims associated with the recoverable balance by vouching to copies of the claim payments. In conjunction with testing performed in the Examination Repository – Reserves/Claims Handling test a sample claims (including those handled by a TPA/MGA) to determine whether claims subject to reinsurance were appropriately identified.

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				provide adequate supporting evidence for the net recoverable balances. If this process is outsourced to a third-party administrator (TPA) or managing general agent (MGA), the insurer has a process in place to monitor the activities of the TPA/MGA (e.g., obtains or performs regular audits, obtains SOC 1 report, requires periodic reporting, etc.).	demonstrating supervisory review of reinsurance recordkeeping. Review audit reports and other documentation to determine whether the insurer provides sufficient oversight of its TPAs/MGAs.	
Significant reinsurance recoverables are overstated or not collectible.	CR	EX VA PD	RRC	The insurer continually monitors the financial solvency of its reinsurers throughout the duration of the reinsurance contracts. The insurer maintains accurate records of its reinsurance recoverables, prepares aging reports and follows up on any past-due amounts in a timely manner.	Review assessments of the reinsurance review performed by internal/external auditors, reinsurers and/or others for significant issues. Obtain documented review of aging reports and support of the collectability of any delinquent uncollected amounts.	Perform procedures related to the NAIC Examination Jumpstart approach to test whether the level of ceded recoverables are reasonably equivalent to the level of assumed liabilities reported by the assuming reinsurers. Obtain and analyze recent financial information of the assuming (re)insurer (e.g., annual financial statement, SEC filings, etc.) or results of insurance industry reporting and rating services (e.g., A.M. Best, S&P, FAS tools, etc.) to determine the credit worthiness of significant reinsurers. Perform procedures to determine the

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
						collectability/existence of reinsurance recoverable balances: • Select a sample of reinsurance recoverable balances and trace to subsequent collection in order to ascertain collectability; or, • For a sample of reinsurance recoverable balances, agree the balance to a valid reinsurance contract, noting whether reinsurance premiums have been paid; the claims are covered under the reinsurance contract; the deductible payments by the ceding insurer have been met; and the balance has been netted against indemnity and paid LAE amounts previously recovered from the reinsurer.
Funds held as security for XXX/AXXX transactions are not adequate to support the reserve.	CR	VA CM	AARP RA	The insurer periodically reviews the underlying security for XXX/AXXX transactions for compliance with applicable state investment laws for the ceding insurer and SSAPs.	Verify that a review of the underlying security for XXX/AXXX transactions is conducted on a periodic basis and subject to management review and approval.	Review the investment portfolio of the ceding insurer to determine compliance with applicable state investment laws for the ceding insurer and SSAPs.

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				For transactions subject to AG 48, the insurer's appointed actuary conducts an analysis of XXX/AXXX reinsurance arrangements on a treaty-by-treaty basis to determine that funds consisting of Primary Security and Other Security are appropriately held by or on behalf of the ceding insurer or that the insurer has established a liability in accordance with AG 48.	Obtain the analysis prepared by the insurer's appointed actuary and verify management review and approval.	For a sample of reinsurance policies not subject to AG 48, review the funds held by or on behalf of the ceding insurer as security for the reinsurance transaction to determine compliance with applicable state investment laws for the ceding insurer and SSAPs. Consider requesting an asset/liability matching run on a standalone basis for all business issued through a reinsurance financing agreement. For a sample of reinsurance transactions subject to AG 48, review the assets held by or on behalf of the ceding insurer that constitute the Required Level of Primary Security to determine whether the requirements for classification of "Primary Security" per AG 48 have been met.
The insurer is not properly calculating the provision for reinsurance. (*P&C Companies*)	OP	AC VA EX CM PD	RRC	The insurer has policies in place to determine whether reinsurers are authorized, unauthorized or certified. A provision for reinsurance is completed for unauthorized and certified reinsurers in accordance with SAP. The insurer maintains and verifies adequacy of funds	Obtain documentation relating to authorized, unauthorized and certified reinsurers. Review support for reinsurer status and evidence of provision calculation and review. Obtain evidence of insurer verification of funds held,	Verify authorization and certified reinsurer status for reinsurers included in the provision for reinsurance calculations. Review letters of credit to verify whether they are clean, irrevocable and issued by a qualified U.S. financial institution, as

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				held, letters of credit, trust account balances or any other forms of collateral. The insurer has controls in place to reconcile the recoverable balances, agings, amounts in dispute and offset payable balances used in the provision calculation to those amounts reported in the general ledger and accounting system. The provision for [illegible] calculation is reviewed by management to ensure [illegible].	letters of credit, trust account balances or any other forms of collateral. Obtain and review the completed reconciliations. Test any significant reconciling items for appropriateness. Obtain evidence of management review.	defined in Appendix A-785 of the *Accounting Practices and Procedures Manual.* Verify the existence and adequacy of funds held, trust account balances or any other forms of collateral. Verify whether the trustee is a qualified U.S. financial institution and that the form of the trust and amounts comply with the laws and regulations of the state of the ceding insurer's commissioner. Identify any significant amounts included in the calculation not previously examined. Perform procedures to ascertain the validity of the amounts and their utilization in the calculation. Recalculate the provision for reinsurance.
Insurer is taking credit for reinsurance contracts with unauthorized reinsurers. (*Non-P&C Companies*)				The insurer has processes in place to segregate authorized, unauthorized and certified reinsurer contracts in accordance with the requirements set forth in Appendix A-785 – Credit for Reinsurance. The insurer includes appropriate collateral requirement provisions in	Perform a walkthrough to gain an understanding of the insurer's process to segregate authorized, unauthorized and certified reinsurer contracts. Obtain contracts to determine whether provision for collateral	Perform procedures to verify that reserve credits are taken appropriately under the requirements of Appendix A-785 of the *Accounting Practices and Procedures Manual* or [illegible] laws and regulations. For example, verify the amount and validity of collateral held in support of credits taken.

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				all contracts with unauthorized and certified reinsurers. The insurer has procedures in place to monitor and obtain additional collateral as it becomes necessary to do so.	requirement is included and adequate. Test the company's processes to review and adjust collateral balances as necessary.	
The insurer is overestimating the reinsurance credit on incurred but not reported (IBNR) loss and IBNR LAE reserves. (See also Examination Repository – Reserves/Claims Handling)	OP	VA A	RRC	The insurer estimates reinsurance credit on IBNR loss and IBNR LAE reserves by reviewing reinsurance treaties in place at the insurer, as well as historical results. The insurer's appointed actuary reviewed in calculating and/or reviewing the estimating the credit amount.	Test the operating effectiveness of the insurer's process to calculate reinsurance credits on IBNR loss and IBNR LAE reserves, including involvement of the appointed actuary, management approval and sign-off.	Consider the reasonableness of reinsurance credits taken, based on a review of the insurer's reinsurance program and treaties in place. Utilize the insurance department actuary or an independent actuary to review the reasonableness of ceded reinsurance estimates included in the opining actuary's report. Compare the credit amounts recorded by the insurer to reinsurers' estimated liability, if available. Recalculate or test actual credits taken on a sample of contracts and verify whether the ceding insurer is correctly applying the term

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EXAMINATION REPOSITORY – RELATED PARTY

Identification of Risks:

To ensure that the examiner appropriately identifies and addresses all relevant risks, it is important that examiners consider information contained within the Own Risk and Solvency Assessment (ORSA), Group Profile Summary (GPS), and insights shared from the Department's Financial Analysts. An understanding of the group, including the Ultimate Controlling Party, will provide the examiner with a roadmap to help in effectively addressing the risks posted to the insurer by its related parties.

Annual Statement Blank Line Items

Listed below are the corresponding Annual Statement line items that are related to the identified risks contained in this exam repository:

Receivables from Parent, Subsidiaries and Affiliates
Payable to Parent, Subsidiaries and Affiliates
Amount Provisionally Held for Deferred Dividend Policies *(Life Companies)*
Dividends to Stockholders Declared and Unpaid *(Life Companies)*

Please Note:

- Transactions resulting from related party tax sharing and reinsurance agreements are typically reported on the appropriate tax and reinsurance financial statement line items, which are not listed above.
- The examiner should consider the company's compliance with the state statutory guidelines when reviewing affiliate and other related-party contracts.
- For additional guidance on related party and intercompany transactions, see Section 1, Part IV, D - Related Party/Holding Company Considerations.

Relevant Statements of Statutory Accounting Principles (SSAPs)

All of the relevant SSAPs related to the related party process, regardless of whether or not the corresponding risks are included within this exam repository, are listed below:

No. 15 Debt and Holding Company Obligations
No. 25 Affiliates and Other Related Parties
No. 64 Offsetting and Netting of Assets and Liabilities
No. 67 Other Liabilities
No. 70 Allocation of Expenses
No. 97 Investments in Subsidiary, Controlled and Affiliated Entities

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
Other Than Financial Reporting Risks						
A related party (including holding company) is overly reliant on the insurer for ongoing surplus support.	LQ	Other	RPHCC	The insurer has policies in place to ensure that dividends paid to affiliates are within regulatory limits, are approved by the board of directors (or committee thereof) and have received regulatory approval (if required) prior to payment. The insurer (or parent) manages its debt levels and liquidity position through capital contributions and other forms of financing, as well as cash flow analysis to ensure that debt burdens do not strain the solvency/liquidity of the parent or the insurer's subsidiaries.	Review insurer documentation showing that dividends are within regulatory limits, are approved by the board of directors (or committee thereof) and have received regulatory approval (if required) prior to payment. Review documentation on internal strategies and practices to ensure debt levels are properly managed and that sufficient liquidity is available to meet obligations.	Assess the insurance holding company organization's structure, overall group structure and the holding company's reliance on its subsidiaries for dividends. Consider the profitability and success of other companies within the holding company, as well as capital resources and debt maturities as part of the assessment. Review historical cash flows from the insurer to its affiliated companies since the last examination, and compare to statutory dividend capacity currently available. Trace all dividends requiring regulatory approval to insurance department documentation.
The insurer is overly reliant on an affiliate for ongoing surplus support. **Please Note**: Review of this risk should be performed in conjunction with the Capital and Surplus Repository.	CR LQ	Other	RPHCC	The insurer monitors the financial position of the affiliate providing surplus support. The affiliate provides a guarantee of its ongoing support for the insurer. The insurer monitors all guarantee agreements and analyzes the guarantor's	Management reviews financial results of the affiliate on a quarterly or annual basis. Obtain documentation supporting the guarantee provided by the affiliate. Verify that management performs an assessment of the guarantor's ability	Review the affiliate's financial position to determine the ability to provide the needed support. Compare the amount guaranteed by the parent/affiliate with the surplus of the insurer receiving the guarantee. Evaluate the possibility the

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				ability to fulfill the agreement if necessary.	to fulfill the agreement on a periodic basis.	guarantee will not be fulfilled and the potential impact to the insurer. Verify any collateral maintained in accordance with the guarantee.
Parent, holding companies or other affiliates might become insolvent or have liquidity issues. **Please Note:** This risk is intended to focus on the strategic or reputational impact if affiliates experience solvency or liquidity issues.	SP	Oth	RPHCC	The insurer monitors parent or holding companies for financial solvency/liquidity issues. The board of directors (or committee thereof) reviews strategic business plans and financial reports for other members of the holding company system and evaluates any risks and new initiatives that could impact the insurer including legal reputational risks and risks. Other entities in the holding company system make presentations to the board to explain operations and risks.	Obtain evidence of review of parent or holding company financial information by the insurer. Ensure liquidity is appropriately considered. Review meeting minutes of the board of directors (or committee thereof) for evidence of discussions and actions taken to mitigate any contagion risks.	Obtain and review parent or holding company financial information (including the Enterprise Risk Report/ORSA if available) for indications of financial solvency or liquidity issues. If significant issues are identified, perform procedures to evaluate the potential solvency impacts. If necessary, notify the financial analyst of the concern and request additional monitoring of the insurer.
Financial Reporting Risks						
The insurer is not properly identifying related-party activities.	OP ST	AC VA PD CM CO	RPHCC	The insurer maintains a list of all related parties — including pension funds and other trusts established for employees, major borrowers and lenders, and significant agents, brokers, producers and providers — that is approved by management	Obtain the related-party [illegible] listing and verify [illegible] the method management uses to ensure completeness and utilization of the list. Review updates to the related party listing to	Perform procedures to identify related parties such as: • Reviewing minutes • Reviewing shareholder listings of closely

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				and provided to key employees. As significant transactions occur, management considers whether new related party relationships have been established which are then added to the list of related parties.	ensure the listing is being properly maintained.	held companies to identify principal shareholders • Reviewing material investment transactions during the period under examination to determine whether they cause another entity to become a related party • Reviewing conflict-of-interest statements obtained by the entity from management and directors. Prepare a list of entities and/or persons that appear to be related parties and compare to management's listing, if one exists. Ask management about the insurer's relationships with these entities and/or persons. Determine whether the entities and/or persons meet the definition of "related party" under the domiciliary state's insurance code. Review accounting records for large, unusual or non-recurring transactions or balances, paying particular

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						attention to transactions recognized at or near the end of the accounting period, which may indicate transactions with related parties that should be disclosed.
The insurer is not properly recording and disclosing related-party activities.	GT	AC [illegible]D CL CO	RPHCC	For identified related parties, the insurer maintains records (e.g. consolidated schedule of intercompany allocations, balances, etc.) so that individual allocations and [illegible]es are easily identifi[illegible]le and amounts that ha[illegible] been offset are identi[illegible]able. The insurer has procedures [illegible] the procedures to ensu[illegible] that related party [illegible]ctivi[illegible]es are properly [illegible]sclosed, reporte[illegible] and re[illegible]ews by supe[illegible]isory personnel. Management reviews contract terms periodically to ensure that they are reasonable and properly reflect current operations.. The insurer has a process	Verify that a review of intercompany balances is performed. Consider whether service transactions are occurring but are not being given accounting recognition, such as receiving or providing accounting, management or other services at no charge to a related party. Determine the materiality of such transactions and the impact on the insurer. Verify that contracts are periodically reviewed and updated for changes in operations. Review a sample of past	For a sample of identified related parties, review transactions to ensure they are being properly reported and disclosed. Review all other related-party disclosures for reasonableness.* Confirm whether the related-party relationship is disclosed in the insurer's holding company registration statement. Review the insurer's transactions with the suspected related party and determine whether the transactions are subject to any prior approval requirements in the domiciliary state's insurance code. Review the contracted [illegible]nsactions with affiliates and determine whether the[illegible] are[illegible]t arm's length [illegible]d properly reported as economic or non-economic[illegible]n accordance with SSAP No. 25.

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				that identifies transactions that are subject to regulator approval and ensures that transactions are approved as appropriate. The insurer has a policy in place that requires written approval from the board of directors (or committee thereof) prior to entering into any loan transaction (lending or borrowing), or guarantees (parental/affiliated surplus support or loan repayment/collateralization) to ensure that transactions meet "fair and reasonable" and "arm's-length" standards.	transactions to confirm management's process was executed, as appropriate. Review meeting minutes of the board of directors (or committee thereof) for evidence of written approval of related-party loans or guarantees.	Obtain the loan document(s) or written guarantee and verify that the terms of the contract are equitable and reasonable. Verify the guarantee or loan was properly disclosed in the annual financial statement and filed with the domiciliary state insurance department, if applicable.
The insurer engages in transactions with affiliates that have inequitable terms.	OP ST	CM AC VA	RPHCC	Management reviews related-party agreements to ensure that all agreements are at arm's length and properly reported as economic or non-economic. The insurer maintains written contracts for significant transactions (expense allocations, tax-sharing agreements, etc.) with related parties that are reviewed to ensure fair and reasonable terms and are approved by the board of directors (or committee thereof) or other appropriate personnel.	Obtain evidence of management's review of related-party agreements. Obtain and review the significant contracts between the insurer and its affiliates. Verify that the insurer reviews the agreements to ensure fair and reasonable terms and approval by the board of directors (or committee thereof) or other appropriate personnel.	Select a sample of agreements and transactions for review to verify the agreements are consummated at arm's length and the transactions are in accordance with the agreements.

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				Management reviews contract terms and actual transactions periodically to ensure that they are reasonable and properly reflect current operations and are in compliance with related party agreements.	Verify that contracts are periodically reviewed and updated for changes in operations.	
Intercompany allocation of general and administrative expenses among affiliates is inappropriate.	OP	VA PD CO	RPHCC	Management reviews cost-allocation contracts to ensure that the basis for expense allocation is fair and reasonable. Expenses to be allocated are identified and reasonable metrics are defined, developed and used for each type of expense. Management reviews the basis of allocation periodically to ensure that it is still reasonable and properly reflects current operations.	Review the insurer's expense allocation worksheets and determine whether the method of allocation follows the contract and is reasonable. Inquire with management regarding changes in operations that might affect expense allocation and verify that those changes are properly reflected.	Test the insurer's calculation of material expense allocation for compliance with the terms of the contract. Reconcile amounts to the general ledger and Underwriting & Investment Exhibit, Part 3, and trace to receipt or payment documentation as applicable.
Intercompany allocation of tax expenses among affiliates is inappropriate.	OP	AC CO OB/OW CM	RPHCC	The insurer has a policy in place to disclose the names of the entities with whom the entity's tax return is consolidated, in accordance with statutory accounting principles (SAP) and applicable tax law. The insurer maintains a written agreement, approved by its board of directors (or committee thereof) that sets forth the	Review the insurer's process to accumulate and disclose entities with which consolidated tax return is filed. Review the written agreement and verify approval by the board of directors (or committee thereof) and the	Review the insurer's allocation methodology for appropriateness and verify the accuracy of the allocation. Verify that tax-related intercompany balances are settled in accordance with written agreements.

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				manner in which the total combined tax is allocable to each consolidated entity.	domiciliary state insurance department.	

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EXAMINATION REPOSITORY – RESERVES/CLAIMS HANDLING (HEALTH)

Annual Statement Blank Line Items

Listed below are the corresponding Annual Statement line items that are related to the identified risks contained in this exam repository:

Claims Unpaid (Less Reinsurance Ceded)
Unpaid Claims Adjustment Expenses
Aggregate Policy Reserves
Aggregate Claim Reserves
Aggregate Health Claim Reserves

Relevant Statements of Statutory Accounting Principles (SSAPs)

The relevant SSAPs related to the health insurance reserving process, regardless of whether or not the corresponding risks are included within this exam repository, are listed below:

No. 3 Accounting Changes and Corrections of Errors
No. 5R Liabilities, Contingencies and Impairments of Assets – Revised
No. 25 Affiliates and Other Related Parties
No. 50 Classifications of Insurance or Managed Care Contracts
No. 54R Individual and Group Accident and Health Contracts
No. 55 Unpaid Claims, Losses and Loss Adjustment Expenses
No. 61R Life, Deposit-Type and Accident and Health Reinsurance – Revised

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risks	Possible Controls	Possible Test of Controls	Possible Detail Tests
Other Than Financial Reporting Risks						
The board of directors (or committee thereof) is not involved in establishing and/or reviewing the insurer's overall reserving practices.	P ST RV	Other	RA	The insurer's board of directors (or committee thereof) has adopted and/or reviewed the insurer's overall reserving practices. The board of directors (or committee thereof) regularly discusses reserving issues and receives reports from the appointed actuary. The report includes an explanation of the reserving policy and methodology, as well as analytical review of the reserves. The insurer monitors and revises its reserving practices as needed.	Verify that the insurer has established overall reserving practices that have been adopted and/or reviewed by the board of directors (or committee thereof). Review board of directors (or committee thereof) minutes to ensure discussion of reserving. Obtain information on revisions made by the insurer to its reserving practices and verify whether the revisions were appropriately reviewed and/or approved by the board of directors (or committee thereof).	Obtain information on the insurer's overall reserving practices and forward it to the insurance department actuary or an independent actuary for review. Discuss with members of the board of directors (or committee thereof) their level of involvement in the monitoring of reserving practices.
Financial Reporting Risks						
New claims are not entered into the claims management system.	RP LG	AC CT CO	RD	Segregation of duties exists between the claim notification and the input of claims data into the claims system. Control reports exist to ensure all claims reported to the insurer electronically or manually have been entered into the claims system.	Observe that segregation of duties exists between the claim notification and the input of claims data into the claims system. Obtain the exception report and ensure management review and resolution of any exceptions.	Select a sample of items from the exception reports and verify that the claim was appropriately accounted for.* Select a sample of claim and expense payments made subsequent to year-end to verify that claims were recorded in the proper

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risks	Possible Controls	Possible Test of Controls	Possible Detail Tests
				Exceptions are identified and resolved timely. The insurer reviews the Type II SOC 1 reports and ensures compliance with user control considerations for any outsourcing companies that enter claims on behalf of the insurer.	Test the operating effectiveness of the automated claims posting process through reperformance and observation, which could include IT testing of batch totals to ensure completeness of transactions processed. Obtain documentation of management's review of the Type II SOC 1 reports.	period. Review Type II SOC 1 reports, including bridge letters, to ensure there are no significant control deficiencies or internal control weaknesses related to processing new claims into the claims system.
Claims data is incomplete or incorrectly entered into the claims management system.	OP LG	AC CT CO EX	RD	Claims data is subject to independent verification or quality assurance (QA) reviews. The claims system has automated controls that will not allow a claim to be entered without a valid in-force policy. The claims system has automated controls that will not permit continued processing until all pertinent claim data has been entered. Entering a valid policy number will automatically	Obtain documentation of independent claim verification or QA review. Ensure reviews performed address the completeness and accuracy of underlying claims information entered into the system. Test the operating effectiveness of automated controls (i.e., edit checks) through reperformance and observation. Obtain the error report and ensure proper resolution of exceptions. Test the operating effectiveness of authority restrictions through	Perform data validation tests to verify the accuracy of claim information maintained in the claims system, such as coverage terms, demographic data, date of service, provider name, service description or code, insured name, claim number and coverage period by vouching the information to the claimant's insurance contract, claims form and any other underlying support.* Scan the database(s) for illogical inconsistencies, such as missing claim amounts, unusually small amounts and claims misclassified by type (e.g.,

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				populate select policy data. System edits will identify data that does not meet the predetermined criteria, resulting in inclusion on a system-generated exception report. Segregation of duties exists between individuals responsible for new claim set-up and those responsible for setting up new policies.	reperformance and observation. Obtain claims set-up and new policy set-up authorization listings and cross-reference the listings to ensure that there are no employees with conflicting authority.	Medicare). In situations where adequate segregation of duties is not apparent, obtain data to determine whether any claims were set up by the same user who created the corresponding policy in the master file. If any instances are identified, investigate the claim to ensure the claim exists and is supported by underlying data.
The third-party administrators (TPAs), or managing general agents (MGAs), are not processing claims in accordance with the insurer's claims procedures as outlined in the TPA agreement.	LG OP RP	AC CM	RD	The insurer performs regular audits of its TPAs/MGAs to determine whether insurer claims handling standards and additional contractual provisions are being consistently followed by the TPA. Management obtains a Type II SOC 1 report for all TPAs and reviews the report to verify whether the TPA has adequate controls and that the insurer is adhering to user control considerations. Management performs necessary reviews to comply with applicable state MGA regulations.	Review audit reports and other documentation to determine whether the insurer provides sufficient oversight of its TPAs/MGAs. Verify that the insurer has obtained and reviewed the TPA's Type II SOC 1 report, if available. Determine whether the insurer is adhering to user control considerations. Obtain evidence of management's review of compliance with applicable state MGA regulations.	Determine, by a review of selected claims, whether the insurer is settling its claims accurately and in accordance with the contract, based on information contained in the claim file.* Review the Type II SOC 1 report to determine whether the controls outlined in the report are adequate to ensure that claims are being processed in accordance with the TPA agreement. Test for compliance with applicable state MGA regulations.
Claims are not being processed accurately and in accordance	OP ST LG	AC CM CO	RD	The insurer has administrative policies and maintains a claims	Review the claims procedures manual to determine its	Perform tests to determine whether claims were accurately processed in

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with insurer guidelines.				procedures manual that outlines the following requirements: • Maximum benefit to be paid based on procedure type. • Usual, customary and reasonable (UCR) limitations. • Proper application of deductibles. • Reserving and payment authority and approval levels. • [illegible] cumentation and tracking • Proced[illegible]es for handling suspicious and/or [illegible]d claims. • Comp[illegible]ance with applicable state fair claims practices law and/or regulations. Automated controls are in place to ensure that paid losses are not to exceed policy limits, cover ineligible loss causes/types and/or apply to a policy period for which insurer is not contractually responsible. Any consideration to pay a loss must be processed in accordance with the insurer's procedures. As part of the claims processing procedures, the	appropriateness, including management approval. Test the operating [illegible]fectiveness of system edit checks to ensure procedures are [illegible]mplemented through reperformance and observation. Review assessments of the claims handling process performed by internal/external auditors, reinsurers and/or others for significant issues. Test the operating	accordance with the claims procedures manual, approved authority limits and administrative policies through review of the claimant's insurance contract, claims form and any other underlying support. Review policyholder complaints and investigate significant issues. Review a sample of denied claims to ensure compliance with contract provisions.*

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				insurer obtains adequate documentation and coverage of benefits before a claim is settled. Claims approval is subject to approved authority limits. A QA review is periodically performed for each claims processor to ensure compliance with the claims handling policies.	effectiveness of controls to ensure adequate documentation is obtained before payment is made. Test the controls in place to ensure that claims are approved in accordance with documented authority limits. Review documentation of QA reviews to determine that the QA function is being executed as outlined in the insurer's policies. On a sample basis, reperform the QA testing to ensure that the testing was completed accurately.	
The claims data utilized by the actuary to estimate reserves does not correspond to the data in the insurer's claims system and to the data in the insurer's accounting records.	OP RV	AC CO	RD	The insurer has established procedures to reconcile actuarial data to the insurer's claims system, the data in the insurer's accounting records and appropriate annual financial statement schedules and/or exhibits. Such reconciliations are reviewed by supervisory personnel. Inventories of reported and unpaid claims are maintained and periodically reconciled to the general ledger.	Review the insurer's reconciliation reports of actuarial data to the insurer's claims system and the insurer's accounting records. Ensure evidence of supervisory review. Review the insurer's reconciliation of reported and unpaid claims to the general ledger.	Test reconciling items within the reconciliations for appropriateness. Reconcile the insurer's actuarial report for claims paid and claims adjustment expenses (CAE) to supporting insurer reports, general ledger and annual financial statement schedules and exhibits as of the valuation date.
Reinsurance is not	RV	AC	RD	The insurer has established	Review the insurer's	Test reconciling items

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properly taken into account in accumulating claims data.		CO		procedures to prepare the claims data for actuarial review in accordance with the insurer's reinsurance treaties.	reconciliation reports of actuarial data to the insurer's claims system, reinsurance reports, and accounting records. Test the operating effectiveness of the insurer's established procedures to include claims data from assumed reinsurance treaties within the data for actuarial review.	relating to reinsurance claims data for appropriateness. Verify assumed reinsurance claims data accumulated for actuarial review by comparing to the data provided by the ceding insurer for completeness.
Initial case reserves are not established or reviewed in accordance with insurer standards.	RV CR	AC VA CO	RX	The insurer has a case reserving philosophy and qualified actuaries are involved in establishing and reviewing the reserving policy. Initial reserves are made in accordance with the insurer's reserving philosophy and within a specified time frame. Claim adjusters/supervisors are required to review significant initial case reserves on a timely basis and make adjustments as necessary. Committees are formed to evaluate and strategize claims involving serious injuries, complex claims	Obtain documentation supporting the insurer's reserving philosophy. Review reserving philosophy for actuary review and policy adequacy. For a sample of loss reserves, determine whether loss reserve reviews were performed and documented in accordance with insurer policy. Obtain a period of new claims reports and verify the insurer reviews significant initial case reserves and makes adjustments, if necessary, in a timely manner. Obtain minutes and other meeting materials from the meetings of the committee to determine whether the	For a sample of reserves verify that the calculation is in accordance with the reserving philosophy and that reserves are calculated on a timely basis.* For a sample of reserves meeting the criteria to go to a claims committee, determine whether the reserves were referred to this committee.* Confirm a sample of unpaid claims with major viders.

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risks	Possible Controls	Possible Test of Controls	Possible Detail Tests
				law, and large or unusual loss reserve determinations or settlements.	committee provided appropriate oversight.	
Case reserves are [illegible] updated accurately.	PV CR	CO VA	RA	The insurer has a policy requiring open claims to be reviewed regularly. When new information is received, case reserves are reviewed and adjusted, if necessary. The claims management system generates analyses of reserve increases and decreases, an outstanding reserve [illegible] an outstanding re[illegible]ve list[illegible] claim [illegible]djuster, and a reserve [illegible]lease re[illegible]t. These reports are [illegible]wed/monitored by the claims [illegible]nagement for reasonableness.	From a sample of case reserves, determine whether the reserves are updated regularly and are appropriately updated when new information is received. Obtain copies of the reserve reports, noting management approval.	Select a sample of paid claims and compare the final overall claims settlement with the case reserve to determine whether the reserves are adequate and/or updated accurately. Verify that the information contained in the reports is accurate and determine whether the appropriate analyses are being used to evaluate the reserves.
The assumptions and methodologies used by the insurer for the health, long-term care and long-term disability business are not accurate and appropriate.	RV	VA AC PD	RA	The insurer uses consiste[illegible] assumptions and methodologies that have been based on historical results (to the extent appropriate), adequately documented, approved by senior management and in accordance with statutory accounting principles and applicable state statutes and/or regulations. Senior management uses either internal or independent actuaries to conduct reserve analyses of all major lines of business on an annual basis.	Gain an understanding of the insurer's assumptions and methodologies and compare with prior periods. Verify that senior management signs off on assumptions and methodologies used by the insurer, including any changes. Verify senior management review of reports from actuaries and that reports include reserve analyses of all major lines of business.	Review assumptions and methodologies for reasonableness, appropriateness and accuracy, with assistance from the insurance department actuary or an independent actuary. Verify that reserving assumptions are in [illegible]rdance with the relev[illegible]t SSAPs related to heal[illegible] reserving, as well as [illegible]y appl[illegible]cable state statutes, regul[illegible]tions, pronounce[illegible]nts and/or bulletins.

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risks	Possible Controls	Possible Test of Controls	Possible Detail Tests
				Actuarial analysis is subject to a peer review process. Management receives regular reports on loss ratios by line or class of business, as well as other key ratios, and reviews unusual fluctuations on a timely basis to review reserves for adequacy. The insurer utilizes a fully staffed, well-qualified actuarial department that is under the direction of a fellow of the Society of Actuaries (FSA), member of the American Academy of Actuaries (MAAA) and is experienced in the lines of business written by the insurer. The reserving actuarial unit's responsibilities are segregated from the pricing actuarial unit, but there is regular communication between the two units. The insurer's organizational structure limits the influence that management can have on the appointed actuary.	If performed in-house, review and test the actuarial peer review process and related sign-offs. Verify management review of reserve reporting and test the operating effectiveness of procedures in place. Review the credentials, background and responsibilities of the insurer's actuarial department (internal or external) for appropriateness. Request and review the insurer's organizational chart and job descriptions to determine whether the functions are separate and distinct. Interview the appointed actuary during the planning phase of the examination to determine whether the insurer's organizational structure is appropriate in	Review prior history of claims development, as well as subsequent claims development data to analyze the reasonableness of assumptions and methodologies. Determine whether the appropriate disclosures have been made in the Notes to the Financial Statements for the changes in reserve methodologies. Review actuarial reports and compare reports to prior periods. Investigate significant variations. Utilize the insurance department actuary or an independent actuary to perform an independent calculation/estimate of the reserves. Review correspondence related to peer review for appropriate depth of review. Compare the opining actuary's assumptions and estimates with those in other available actuarial analyses. Determine whether the Actuarial Opinion was changed by the appointed actuary after meeting with

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risks	Possible Controls	Possible Test of Controls	Possible Detail Tests
					this area. Review insurer processes in place to calculate the reserve calculations to ensure consideration is given to policy lapse rates.	insurer management.
The claims unpaid, claims reserve, policy reserve and premium deficiency reserve computations are not performed correctly or the selected estimates are unreasonable.	OP RV	AC VA	RA	The insurer has an established process (although assumptions and methodologies may change) to estimate the claims unpaid, claim reserves, policy reserves and premium deficiency reserves on an annual basis. The insurer maintains a fully qualified, well-qualified actuarial department that is under the direction of a member of the American Academy of Actuaries (MAAA) and is experienced in the lines of business written by the insurer. Senior management uses either internal or independent actuaries to conduct reserve analyses of all major lines on an annual basis. The actuarial calculations are subject to a peer review	Review the process in place (which may include performance of a walkthrough) to estimate the claims unpaid, claim reserves, policy reserves and premium deficiency reserves. Review the credentials, background and responsibilities of the insurer's actuarial department staff for appropriateness. Obtain actuarial reports to verify insurer is using either independent or in-house actuaries to perform the reserve calculations on all major lines of business annually and verify senior management review. If performed in-house, review and test the actuarial	Utilize the insurance department actuary or an independent actuary to perform an independent estimate of the claims unpaid, claims reserve, policy reserve and premium deficiency reserves. Perform analytical procedures to review the reasonableness of reserve estimates.

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risks	Possible Controls	Possible Test of Controls	Possible Detail Tests
				process. The insurer's board of directors (or committee thereof) receives an annual presentation on the actuarial analysis process. Management receives regular reports on claims ratios (including claims unpaid, claims reserve, policy reserve and premium deficiency reserve) by line of class of business for accident year and calendar year as well as other key ratios, and reviews unusual fluctuations on a timely basis to review reserves for adequacy.	peer review process and related sign-offs. Review the board of directors (or committee thereof) minutes to verify that a presentation was given on the actuarial analysis process. Verify management review of reserve reporting and test the operating effectiveness of procedures in place.	
The claims adjustment expense (CAE) computations are not performed correctly.	OP RV	AC VA CO	RA	The insurer has established processes to estimate both the cost containment and other claim adjustment reserves on an annual basis. The insurer maintains a fully staffed, well-qualified actuarial department that is under the direction of a fellow of the Society of Actuaries (FSA) or member of the American Academy of Actuaries (MAAA) and is experienced in the lines of business written by the	Review the processes (which could include a walkthrough) in place to calculate both the cost containment and other claim adjustment reserves. Review the credentials background and responsibilities of the insurer's actuarial department staff for appropriateness. Obtain actuarial reports to verify the insurer is using either independent or in-	Utilize the insurance department actuary or an independent actuary to perform an independent calculation/estimate of the CAE. Perform analytical procedures to review the reasonableness of CAE calculations.

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risks	Possible Controls	Possible Test of Controls	Possible Detail Tests
				insurer. Senior management uses either internal or independent actuaries to conduct separate cost containment and other claim adjustment reserve analysis of all major lines on an annual basis. The actuarial analyses are subject to a peer review process. The insurer's board of directors (or committee thereof) receives an annual presentation on the actuarial analysis process. Management receives regular reports on loss ratios by line or class of business, as well as other key ratios, and reviews unusual fluctuations on a timely basis to review reserves for adequacy.	house actuaries to perform separate cost containment and other claim adjustment reserve analyses on an annual basis. Verify senior management review of reports from actuaries. If the analyses are performed in-house, review and test the actuarial peer review process and related sign-offs. Review the board of directors' (or committee thereof) meeting minutes to verify whether a presentation was given on the actuarial analysis process. Verify management review of reserve reporting and test the operating effectiveness of procedures in place.	
Changes in the legal environment or changes in the	OP RV ST	VA PD AC	RA	The insurer has procedures in place for its legal department to monitor and	Review the insurer's process to monitor changes in the legal environment	Through a review of the actuarial reports, determine whether changes in the legal

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insurer's underwriting, claim reserving and claim handling processes are not appropriately considered within the insurer's reserving assumptions and methodologies.				communicate changes in the legal environment (e.g., changes in case law, award amounts, trends in the number of claims being litigated) are being taken into consideration by the reserving unit in a timely manner. The insurer has procedures in place for the underwriting, case reserving and claims handling units to communicate changes in the processes to the reserving unit in a timely manner.	that may affect the reserving process. Review evidence of communication between the reserving unit and other relevant insurer units.	environment and/or changes in the insurer's internal processes have been properly incorporated in the insurer's reserving assumptions and methodologies.
The computations of reinsurance credits within the reserves are not performed correctly. (See also Examination Repository – Reinsurance Ceding Insurer)	CR RV	AC VA CO	RA	The actuary calculates the reserves on a gross basis and determines the net basis by estimating the reinsurance credits and applying them to the gross reserve. The insurer applies reinsurance credits to reserves by reviewing reinsurance treaties in place at the insurer, as well as historical results.	Test the operating effectiveness of the insurer's process for reviewing the reserve analysis to determine whether reserves have been established on a gross basis, including management approval and sign-off. Test the operating effectiveness of the insurer's process for estimating reinsurance credits for reserves, including management approval and sign-off.	Compare the annual financial statement net and gross incurred and paid loss presentation for consistency with reinsurance treaties in place at the insurer. Consider the reasonableness of reinsurance credits taken, based on a review of the insurer's reinsurance program and treaties in place.
The insurer is not properly recording case reserves (assumed or ceded) for contracts subject to	RV CR LG	CO VA AC	RA	The insurer has policies in place to verify that case reserves subject to reinsurance are valid and accurate (within contract	Review insurer policies to determine appropriateness, noting management approval.	Utilize the NAIC Examination Jumpstart report to determine whether case reserves recorded by the insurer agree with the

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reinsurance.				time frame, covered under the contract, etc.).	Review documentation of insurer's review of claim validity.	case reserves of the assuming (ceding) insurer.
Management books reserves that are materially different than the actuary's best estimate.	OP ST LG	VA PD	RA	The insurer has a process in place to ensure that reserves are recorded based on the actuary's best estimate, or documents an appropriate reason for any deviations. The board of directors (or committee thereof) reviews management's best estimate of booked reserves and challenges such estimates based on reports received, including the actuarial report from the appointed actuary. The insurer's organizational structure limits the influence that management can have on the appointed actuary.	Review management guidelines regarding the recording of actuarially determined reserves. Verify that deviations from the actuary's best estimate are properly documented, if applicable. Review the board of directors (or committee thereof) meeting minutes to for evidence of a presentation and review of information supporting management's best estimate of the booked reserves (i.e., the actuarial report). Interview the appointed actuary during the planning phase of the examination to determine whether the insurer's organizational structure is appropriate in this area.	Review the actuarial report, as well as the annual financial statements and other appropriate documentation, to determine whether the insurer has booked the actuary's best estimate. Review the documentation supporting a deviation from the actuary's best estimate for reasonableness, if applicable.
The insurer does not maintain an adequate premium deficiency reserve.	RV RQ OP	VA CO CM	RA	The insurer has a process in place to review for premium deficiencies on an annual basis in accordance with SSAP No. 54. Independent actuaries review and sign off on deficiency reserve calculations.	Review the process in place and verify key controls surrounding the calculation of premium deficiency reserves. Obtain the actuarial opinion and verify approval of deficiency reserve calculations.	Perform an analytical review of loss ratios. If necessary, utilize the insurance department actuary or an independent actuary to perform a detailed review or an independent calculation/estimate of the premium deficiency reserves.

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EXAMINATION REPOSITORY – RESERVES/CLAIMS HANDLING (LIFE)

Annual Statement Blank Line Items

Listed below are the corresponding Annual Statement line items that are related to the identified risks contained in this exam repository:

Aggregate Reserve for Life Contracts
Aggregate Reserve for Accident and Health Contracts
Liability for Deposit-Type Contracts
Contract Claims

Relevant Statements of Statutory Accounting Principles (SSAPs)

All of the relevant SSAPs related to the life insurance reserving process, regardless of whether or not the corresponding risks are included within this exam repository, are listed below:

No. 5R Liabilities, Contingencies and Impairments of Assets – Revised
No. 50 Classifications of Insurance or Managed Care Contracts
No. 51 Life Contracts
No. 54 Individual and Group Accident and Health Contracts
No. 55 Unpaid Claims, Losses and Loss Adjustment Expenses
No. 61R Life, Deposit-Type and Accident and Health Reinsurance – Revised
No. 63 Underwriting Pools
No. 70 Allocation of Expenses

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Other Than Financial Reporting Risk						
The board of directors (or committee thereof) is not involved in establishing and/or reviewing the insurer's overall reserving practices.	ST RV	Other	RA	The insurer's board of directors (or committee thereof) has adopted and/or reviewed the insurer's overall reserving practices. The board of directors (or committee thereof) regularly discusses reserving issues and receives reports from the appointed actuary. The report includes an explanation of the reserving policy and methodology, as well as an analytical review of the insurer's reserves. The insurer monitors and revises its reserving practices as needed.	Verify that the insurer has established overall reserving practices that have been adopted and/or reviewed by the board of directors (or committee thereof). Review board of directors (or committee thereof) minutes to ensure regular discussion of reserving issues including reports (at least annually) from the appointed actuary. Obtain information on revisions made by the insurer to its reserving practices and verify the revisions were appropriately reviewed and/or approved by the board of directors (or committee thereof).	Obtain information on the insurer's overall reserving practices and forward it to the insurance department actuary or an independent actuary for review. Discuss with members of the board of directors (or committee thereof) their level of involvement in monitoring the implementation of reserving practices.
The insurer has not taken appropriate steps to prepare for the implementation of Principle-Based Reserving (PBR). Note: Under the requirements of the Valuation Manual, companies have until 1/1/2020 to implement	RV ST	Other	RA RD	The insurer has a PBR implementation plan that includes consideration of staffing needs and appropriate expertise in current and/or future budgets and strategic plans.	Verify staff budgets and/or strategic plans contain consideration of PBR implementation needs including qualified staff. Determine if the company has adequate suitability requirements in place for the actuarial department that requires the actuarial staff to be qualified to implement	Review the insurer's PBR implementation plan for reasonableness. Review actuarial department staff qualifications to determine if suitability requirements are met and/or determine if actuarial staff has adequate training available for implementation of PBR.

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PBR requirements. See Section 10 for further information on the implementation of PBR.				The insurer has a process to monitor the progress and ongoing needs of PBR implementation. Data reporting and system needs are reviewed by management on a periodic basis in preparation for PBR implementation.	and practice a PBR methodology. Review the insurer's procedures to determine if pending PBR implementation needs are continuously monitored by company personnel. Verify that management reviews data reporting and system needs.	Consider involving an IT specialist in a review of system capabilities necessary for PBR implementation.
Financial Reporting Risks						
In-force data is not complete or accurate nor consistent with accounting records	OP RV	CO AC	RD	The insurer has established appropriate internal controls over input and maintenance of in-force data as outlined in the Examination Repository – Underwriting. The in-force data is tested periodically by the insurer's quality assurance (QA) function for completeness and accuracy. The insurer's system is programmed to issue insurance contracts utilizing sequential policy numbers.	Perform tests to verify the operating effectiveness of policy in-force controls as outlined in the Examination Repository – Underwriting. Review the QA reports documenting the testing of in-force data to verify the operating effectiveness of the controls. Verify through observation and/or reperformance that system parameters prohibit the issuance of non-sequential policy numbers. Ensure management review of exceptions. Test reconciliation process for supervisory review,	Obtain a copy of the listing detailing in-force insurance contracts provided to the insurer's actuary. Perform procedures to verify the completeness of this listing by tracing to the database a sample of contracts selected from sources outside the reserve system (e.g., premium cash collections). Use control totals for face amount, benefits, and policy count in order to detect use of incorrect files.* In conjunction with the testing performed in the Examination Underwriting Repository, select a sample of in-force insurance contracts to verify that the system data reflects the actual insurance contract

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				records on a periodic basis.	appropriateness and operating effectiveness.	provisions.* Review complaint logs for misapplied payments, missing policy documentation and investigate the status of the complaint. Reconcile data elements to AS reporting.
The data utilized in the company's PBR model is not representative and consistent with the company's in-force data.	OP RV	AC CO	RI	The insurer maintains a model validation process to confirm that model cells repre[illegible] actual inforce da[illegible].	Review documentation associated with the model validation process performed by the company to ensure agreement between the insurer's model and aggregated in-force data for attributes such as: *Issue age *Gender *Policy counts *Face amounts *Fund values *Annualized premium	Compare in-force aggregation and statistics for products under scope of PBR to model output reports at period zero for attributes such as: *Average issue age *Gender distribution *Total policy counts *Total face amounts *Total fund values *Total annualized premium
In-force data is not appropriately restricted and protected to maintain accurate and complete data.	OP	AC CO	RA	The insurer maintains logical access controls, including password protection and active directories, to properly restrict access to in-force data. The insurer has appropriately segregated its duties to ensure that individuals with the ability	Test the operating effectiveness of logical access controls by reviewing documentation relating to re[illegible] for access and by attempting to have unauthorized individuals access the in-force data. Test the operating effectiveness of segregation controls by attempting to have individuals authorized	Select a sample of in-force policy data at the examination as of date for accuracy and completeness testing. * [illegible] a sample of changes made to in-force policies duri[illegible] the year by reviewing supporting documentation.*

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				to update in-force data do not have conflicting responsibilities. The insurer has established policies and procedures for making accurate, timely changes to policies. The insurer has established a QA process to review changes to policies to ensure compliance with the insurer's policies and procedures on a sample basis.	to access in-force data access claims processing or other systems. Perform a walkthrough to gain an understanding of the insurer's process to make changes to in-force policies. Test a sample of changes to policies reviewed by the QA function for proper implementation of the insurer's policies and procedures.	
Reinsurance is not properly taken into account in accumulating in-force data. (See also Examination Repository – Reinsurance Assuming Insurer.)	RV	AC CO	RD	The insurer has established procedures to prepare the in-force data for actuarial review in accordance with the insurer's reinsurance treaties.	Review the insurer's reconciliation reports of actuarial data to the insurer's in-force system, reinsurance reports, and accounting records. Test the operating effectiveness of the insurer's established procedures to include in-force data from assumed reinsurance treaties within the data for actuarial review.	Test reconciling items relating to reinsurance in-force data for appropriateness. Verify the assumed reinsurance in-force data accumulated for actuarial review by comparing to the data provided by the ceding insurer for completeness. Utilize the NAIC Examination Jumpstart report to compare in-force amounts reported by the assuming insurer to those amounts reported by the ceding insurer.
The insurer does not properly monitor XXX/AXXX reserve development related to its ceded reinsurance transactions.	RV	AC VA	RA	The insurer monitors actual experience on ceded reinsurance relative to the initial or most recent projections and monitors underlying assumptions to	Review the insurer's process to monitor experience on ceded reinsurance transactions and verify that material adverse deviations are reviewed by	Determine whether the insurer's ceded reinsurance transactions are tracking appropriately relative to the initial or most recent projections and underlying

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				evaluate asset adequacy and report any material adverse deviations to management.	management.	assumptions. For example, compare actual deaths under the reinsurance transaction with expected deaths assumed in the reserve under the reinsurance transaction. Consider utilizing an actuarial specialist to assist in this determination.
The assumptions and methodologies used by the insurer for life, A&H and deposit-type contracts are not accurate or appropriate.	RV	V AC PD	R	The insurer uses consistent assumptions and methodologies that have been based on guidelines outlined in the *Valuation Manual (VM)* and Appendix A and Appendix C of the NAIC *Accounting Practices and Procedures Manual* (to the extent appropriate), adequately documented, approved by [illegible] management, and in accordance with statutory accounting principles (SAP) and applicable state statutes and/or regulations. Senior management uses internal or independent actuaries to conduct reserve analyses of all major lines of business on an annual basis. The insurer maintains a fully staffed, well-qualified actuarial department	Gain an understanding of the insurer's assumptions and methodologies and compare with prior periods. Verify that senior management signs off on assumptions and methodologies used by the insurer, including any changes. Verify senior management review of reports from actuaries and that reports include reserve analyses of all major lines of business. Review the credentials, background and responsibilities of the insurer's actuarial department staff.	Review assumptions and methodologies for reasonableness, appropriateness, accuracy, and compliance with the *Valuation Manual* and Appendix A and Appendix C of the NAIC *Accounting Practices and Procedures Manual*, with assistance from the insurance department actuary or an independent actuary. Compare actual investment, mortality, morbidity, lapse, interest crediting strategy and expense experience to assumptions, by line of business and to prior-period assumptions. Verify whether the assumptions surrounding contingent claim liabilities are in accordance with the [illegible] SAP, as well as applicable statutes, regulations, pronouncements and/or bulletins.

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				Actuarial analysis is subject to a peer review process. Management receives regular reports on claim liabilities (including IBNR) by line or class of business, as well as other key ratios, and reviews unusual fluctuations on a timely basis to review claim liabilities for adequacy.	If performed in-house, review and test the actuarial peer review process and related sign-offs. Verify management review of contract claim liabilities reporting and test the operating effectiveness of procedures in place.	Utilize the insurance department actuary or an independent actuary to perform an independent calculation/estimate of the life reserves and incurred but not reported (IBNR) contract claims liability. Determine whether the appropriate disclosures have been made in the Notes to the Financial Statements for any changes in reserve methodologies. Review actuarial reports and compare reports to prior periods. Investigate significant variations. Review correspondence related to any peer reviews performed for appropriate depth of review.
The assumptions used by the insurer to calculate reserves for policies subject to Principle-Based Reserving are not accurate or appropriate.	RV	VA AC PD	RA	The company utilizes the prescribed valuation assumptions of the Valuation Manual to calculate PBR reserves. The company maintains credible experience data to support all assumptions utilized in PBR reserving, including: • Lapse • Mortality • Morbidity	Utilize a Department actuary, independent actuary or NAIC Actuarial Modeling support staff to review company documentation that provides support for assumptions and evidence that they are developed in accordance with the requirements of PBR as published in the Valuation Manual.	Utilize a Department actuary, independent actuary or NAIC Actuarial Modeling support staff to verify and validate that the Company has followed the requirements of PBR as prescribed in the Valuation Manual in developing assumptions.

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				• Interest rate • Etc.		
Policies with supplemental or accelerated benefits have not been properly separated and reserved for in accordance with SAP.	OP RV	AC	RA RD	The insurer has a process in which supplemental and accelerated benefits are properly identified and reserved.	Test the process surrounding the identification and reserving of supplemental and accelerated benefits.	Utilize the insurance department actuary or an independent actuary to perform an independent calculation of the reserves of supplemental and accelerated benefits. Verify that reserves are in accordance with SAP.
Policies subject to Principle-Based Reserving are not properly identified or exclusion testing is not appropriately conducted.	RV	VA AC PD	RA	Company conducts and reviews exclusion testing in accordance with Valuation Manual instructions.	Review company support and supervisory sign-off for exclusion testing.	Utilize a Department actuary, independent actuary or NAIC Actuarial Modeling support staff to conduct or reperform exclusion testing.
The life, A&H and deposit-type reserve and IBNR contract claim liability computations are not performed correctly or the selected estimates are unreasonable.	OP RV	AC VA	RA	The insurer has established processes that is consistent with the methods adopted by the NAIC to calculate the life reserves on an annual basis. The insurer maintains a fully staffed, well-qualified actuarial department. Senior management uses internal or independent actuaries to conduct reserve analyses of all major lines on an annual basis.	Review the process in place (which may include performance of a walkthrough) to estimate the life reserves. Review the credentials, background and responsibilities of the insurer's actuarial department staff. Obtain actuarial reports to verify whether the insurer is using independent or in-house actuaries to perform the reserve calculations on all major lines of business annually and verify senior management review of	Utilize the insurance department actuary or an independent actuary to perform an independent estimate of the life reserves and IBNR contract claims liability. Perform analytical procedures to review the reasonableness of reserve calculations.

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				The actuarial calculations are subject to a peer review process. The insurer's board of directors (or committee thereof) receives an annual presentation on the actuarial analysis process. Management receives regular reports on key ratios and reviews unusual fluctuations on a timely basis. Reviews reserves for adequacy.	reports from actuaries. If performed in-house, review and test the actuarial peer review process and related sign-offs. Review the meeting minutes of the board of directors (or committee thereof) to verify whether a presentation was given on the actuarial calculation process. Verify management review of reserve reporting and test the operating effectiveness of procedures in place.	
The methodologies utilized in PBR are not appropriate or the reserve computations are not performed correctly.	OP RV	AC VA	RA	The company has a formal process in place to develop and validate a model for use in PBR. Governance of the actuarial model includes consideration of: • Security Process • Software Change Process • Parameter Setting Process • Validation Process • Oversight of Overall Model Processes	Review evidence that the company followed its process in developing and validating its model for use in PBR. Review the credentials, background and responsibilities of the insurer's actuarial department staff developing and validating the model used in PBR. Ensure that company peer review process is in place and operating effectively.	Utilize a Department actuary, independent actuary or NAIC Actuarial Modeling support staff to review and evaluate results (e.g. compare results of the standard portfolio, reasonableness in comparison with prior periods, etc.) of the insurer's modeling computations. Utilize a Department actuary, independent actuary or NAIC Actuarial Modeling support staff to recalculate reserves on selected policies.

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				Model results have undergone peer review and are subject to reasonableness tests, such as: • The insurer manually calculates Net Premium Reserve (NPR) on selected policies. • The insurer compares reserves per 1000 of face amount with prior periods. • The insurer performs sensitivity testing of key non-prescribed assumptions.		
The computation of reinsurance credits within life, A&H and deposit-type reserves are not performed correctly. (See also Examination Repository – Reinsurance Ceding Insurer.)	CR RV	AC VA CO	RA	The reserving actuary calculates the reserve on a gross basis and determines the net basis by estimating the reinsurance credits and applying them to the gross reserve. The insurer applies reinsurance credits to life reserves by reviewing reinsurance treaties in place at the insurer, as well as historical results.	Test the operating effectiveness of the insurer's process for reviewing the reserve analysis to determine whether life reserves have been estimated on a gross basis, including management approval and sign-off. Test the operating effectiveness of the insurer's process to estimate reinsurance credits for life reserves, including management approval and sign-off.	Compare the annual financial statement net and gross incurred for consistency with reinsurance treaties in place at the insurer. Consider the reasonableness of reinsurance credits taken, based on a review of the insurer's reinsurance program and treaties in place.

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						Compare the corresponding reserve held by the reinsurer with the credit taken by the insurer and identify all reasons for differences.
The insurer does not properly adjust the terminal reserve computation back to the reporting date.	OP RV	AC	RA	The insurer has a process in place whereby reserve computations are adjusted back to the reporting date.	Test the key controls surrounding the process by which reserve computations are adjusted back to the reporting date.	Utilize the insurance department actuary or an independent actuary to perform an independent estimate of the reserve adjustment back to the reporting date.
The initial reserves calculated by the actuary do not adequately reflect reserve liabilities.	OP RV	VA	RA	The insurer has a process in place by which it computes an asset adequacy test on the calculated life reserves. The insurer has a process in place to ensure that the correct assumptions and methodologies are used to estimate the adequacy of life reserves. Management reviews the asset adequacy test for reasonableness of the reserve amount.	Test the key controls surrounding the process by which the reserve adequacy test is calculated. Test the key controls surrounding the assumptions and methodologies used to estimate reserve adequacy. Verify management review asset adequacy test.	Utilize the insurance department actuary or an independent actuary to perform an independent estimation of the reserve adequacy test to determine whether the overall reserve liability is adequate.
Management books reserves that are materially different than the actuary's best estimate.	OP ST LG	VA PD	RA	The insurer has a process in place to ensure that reserves are recorded based on the actuary's best estimate, or documents an appropriate reason for any deviations. The board of directors (or committee thereof) compares the booked	Review management's guidelines regarding the recording of actually determined reserves, verify that deviations from the actuary's best estimate are properly documented, if applicable. Review meeting minutes of the board of directors (or committee thereof) for	Review the actuarial report, as well as the annual financial statement and other appropriate documentation, to determine whether the insurer booked the actuary's best estimate. Review the documentation supporting a deviation from the actuary's best estimate

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				reserves to the amounts included in the actuarial report by receiving a report from the appointed actuary. The insurer's organizational structure limits the influence that management can have on the appointed actuary.	evidence of a presentation and review of the actuarial report. Interview the appointed actuary during the planning phase of the examination to determine whether the insurer's organizational structure is appropriate in this area.	for reasonableness, if applicable.
The insurer is not properly accounting for cash surrender value (CSV) on life (including annuities) contracts.	OP LG	OB/O PD	RA	The insurer has policies in place to ensure the reporting of CSVs on life (including annuities) contracts in accordance with SSAP No. 51.	Ensure the policies for the process used to report CSVs on life (including annuities) contracts is periodically reviewed and approved by management.	For a sample of life (including annuities) contracts with cash surrenders, determine whether the CSV is being properly reported.
Contract claim liabilities are not established or reviewed in accordance with the insurer's standards and applicable statutory guidelines.	RV CR	AC VA CO	RA	The insurer has a policy for recording contract claim liabilities and reserves are involved in establishing and reviewing the policy. Contract claim liabilities are recorded in accordance with the insurer's policy, applicable statutory guidelines and within a specified time frame. Committees evaluate and strategize claim liabilities involving large or unusual loss contract claim determinations and/or settlements.	Obtain documentation supporting the insurer's contract claim liability policy to ensure actuary review and policy adequacy. For a sample of contract claim liabilities, determine whether contract claim reviews were performed and documented in accordance with the insurer's policy and applicable statutory guidelines. Obtain minutes and other meeting materials from the meetings of the committee to determine whether the committee provided appropriate oversight.	For a sample of contract claim liabilities, verify that the calculation is in accordance with the insurer's policy, applicable statutory guidelines, and are calculated on a timely basis. From the sample selected above, identify any claims included on the detail for which the liability recorded is not consistent with the contract terms. Identify claims that appear to have not been paid in a reasonable or fair time frame. Investigate the status of the claim or benefits with the insurer's management.*

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
						Verify that the claims/benefits liability is complete and properly recorded at year-end. Obtain a detail of resisted claims and claims closed without payment. Perform procedures to verify the grounds for the resisted claims. For a sample of contract claim liabilities meeting the criteria to go to a loss/benefits committee, determine whether the liabilities were referred to this committee.*
The insurer does not maintain an adequate premium deficiency reserve.	RV RQ OP	VA CO CM	RA	The insurer has a process in place to review for premium deficiencies on an annual basis in accordance with SSAP No. 54. Independent actuaries review and sign off on deficiency reserve calculations.	Review the process in place and verify key controls surrounding the calculation of premium deficiency reserve. Obtain the actuarial opinion and verify approval of deficiency reserve calculations.	Perform an analytical review of loss ratios. If necessary, utilize the insurance department actuary or an independent actuary to perform a detailed review or an independent calculation/estimate of the premium deficiency reserves.

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EXAMINATION REPOSITORY – RESERVES/CLAIMS HANDLING (P&C)

Annual Statement Blank Line Items

Listed below are the corresponding Annual Statement line items that are related to the identified risks contained in this exam repository:

Losses
Loss Adjustment Expenses
Ceded Reinsurance Case Loss and Loss Adjustment Expense Reserves
Supplemental Reserve (*Title Companies*)

Relevant Statements of Statutory Accounting Principles (SSAPs)

All of the relevant SSAPs related to the property and casualty insurance reserving process, regardless of whether or not the corresponding risks are included within this exam repository, are listed below:

No. 5R Liabilities, Contingencies and Impairments of Assets – Revised
No. 54R Individual and Group Accident and Health Contracts
No. 55 Unpaid Claims, Losses and Loss Adjustment Expenses
No. 57 Title Insurance
No. 62R Property and Casualty Reinsurance – Revised
No. 63 Underwriting Pools
No. 65 Property and Casualty Contracts
No. 70 Allocation of Expenses

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Other Than Financial Reporting Risks						
The board of directors (or committee thereof) is not involved in establishing and/or reviewing the insurer's overall reserving practices.	P RV ST	Other	RA	The insurer's board of directors (or committee thereof) has adopted and/or reviewed the insurer's overall reserving practices. The board of directors (or committee thereof) regularly discusses reserving issues and receives reports from the appointed actuary. The report includes an explanation of the reserving policy and methodology, as well as analytical review of the insurer's reserves. The insurer monitors and revises its reserving practices as needed.	Verify that the insurer has established overall reserving practices that have been adopted and/or reviewed by the board of directors (or committee thereof). Review board of directors (or committee thereof) minutes to ensure discussion of reserving. Obtain information on revisions made by the insurer to its reserving practices and verify the revisions were appropriately reviewed and/or approved by the board of directors (or committee thereof).	Obtain information on the insurer's overall reserving practices and forward it to the insurance department actuary or an independent actuary for review. Discuss with members of the board of directors (or committee thereof) their level of involvement in the monitoring of reserving practices.
Financial Reporting Risks						
New claims are not entered into the claims management system.	RP LG	AC CT CO	RD	Segregation of duties exists between the claim notification and the input of claims data into the claims system. Control reports exist to ensure all claims reported to the insurer electronically or manually have been entered into the claims system.	Observe that segregation of duties exists between the claim notification and the input of claims data into the claims system. Obtain the exception report and ensure management review and exception resolution.	Select a sample of items from the exception reports and verify that the claim was appropriately accounted for.* Select a sample of claim and expense payments made subsequent to year-end to verify that claims were recorded in the proper

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				Exceptions are identified and resolved timely. The insurer reviews the Type II SOC 1 report and ensures compliance with user control considerations for any outsourcing companies that enter claims on behalf of the insurer.	Test the operating effectiveness of the automated claims posting process through reperformance and observation, which could include IT testing of batch totals to ensure completeness of transactions processed. Obtain documentation of the management's review of the Type II SOC 1 report.	period. Review the Type II SOC 1 report, including any bridge letters, to ensure there are no significant control deficiencies or internal control weaknesses related to processing new claims into the claims system.
Claims data is incomplete or incorrectly entered into the claims management system.	OP LG	AC CT CO EX	RD	Claims data is subject to independent verification or quality assurance (QA) reviews. The claims system has automated controls that will not allow a claim to be entered without a valid in-force policy. The claims system has automated controls that will not permit continued processing until all pertinent claim data has been entered. Entering a valid active policy number will	Obtain documentation of independent claim verification or QA review. Ensure reviews performed address the completeness and accuracy of underlying claims information entered into the claims system. Test the operating effectiveness of automated controls (i.e., edit checks) through reperformance or observation. Obtain the error report and ensure proper exception resolution. Test the operating effectiveness of authority restrictions through	Perform data validation tests to verify the accuracy of claim information maintained in the claims system — such as coverage terms, demographic data, loss occurrence and/or loss report date, date of service, insured name, claim number and coverage period — by vouching the information to the claimant's insurance contract, claims form and any other underlying support. Scan the database(s) for illogical inconsistencies, such as missing claim amounts, unusually small amounts and claims misclassified by type.

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				automatically populate select policy data. System edits will identify data that does not meet the predetermined criteria resulting in inclusion on a system generated exception report. Segregation of duties exists between individuals responsible for new claim set-up and those responsible for setting up new policies.	reperformance and observation. Obtain claims set-up and new policy set-up authorization listings and cross-reference the listings to ensure that there are no employees with conflicting authority.	In situations where adequate segregation of duties is not apparent, obtain data to determine whether any claims were set up by the same user who created the corresponding policy in the master file. If any instances are identified, investigate the claim to ensure the claim exists and is supported by underlying data.
The third-party administrators (TPAs) or managing general agents (MGAs) are not processing claims in accordance with the insurer's claims procedures as outlined in the TPA agreement.	LG OP RP	AC CM	RD	The insurer performs regular audits of its TPAs/MGAs to determine whether the insurer's claims-handling standards and additional contract provisions are being consistently followed by the TPA. Management obtains a Type II SOC 1 report for all TPAs and reviews the report to verify the TPA has adequate controls and that the insurer is adhering to user control considerations. Management performs necessary reviews to comply with applicable state MGA regulations.	Review audit reports and other documentation to determine whether the insurer provides sufficient oversight of its TPAs/MGAs. Verify that the insurer has obtained and reviewed each TPA's Type II SOC 1 report, if available. Determine whether the insurer is adhering to user control considerations. Obtain evidence of management's review of compliance with applicable state MGA regulations.	Determine, by a review of selected claims, whether the insurer is settling its claims accurately and in accordance with the contract, based on information contained in the claim file. Review the Type II SOC 1 report to determine whether the controls outlined in the report are adequate to ensure that claims are being processed in accordance with the TPA agreement. Test for compliance with applicable state MGA regulations.

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Claims are not [illegible] processed accurately and in accordance with the insurer's guidelines.	OP T LG	AC CM CO	RD	The insurer has administrative policies and maintains a claims procedures manual that outlines the following requirements: • Proper application of deductibles. • Reserving and payment authority and approval levels. • File documentation and tracking. • Procedures for [illegible]ing suspicious or fraudulent claims. • Compliance with the domiciliary state's fair claims practices laws and regulations. Paid losses are not [illegible] exceed policy limits, cover ineligible loss causes, types and/or apply to a policy period for which the insurer is not contractually responsible. Any consideration to pay a loss that meets one or more of the aforementioned categories must be processed in accordance with the insurer's procedures. As part of the claims processing procedures, the	Review the insurer's claims manual to determine appropriateness including management approval. Test the operating effectiveness of system edit checks to ensure procedures are [illegible]mented through [illegible]ance and [illegible]vation Review ass[illegible]sment of h claims-hand[illegible]g proces performed by internal/external aud[illegible]tors, reinsurers and/or others for significant issues. Test the operating effectiveness of controls to ensure adequate	Perform tests to determine whether claims were accurately processed in accordance with the claims procedures manual, approved authority limits and administrative policies, through review of the claimant's insurance contract, claims form and any other underlying support.* Review policyholder complaints and investigate significant issues. Review a sample of denied claims to ensure compliance with contract and timeliness provisions.

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				insurer obtains adequate documentation before a claim is settled. Claims approval is subject to approved authority limits. A QA review is periodically performed for each claims processor to ensure compliance with the claims-handling policies.	documentation is obtained before payment is made. Test the controls in place to ensure that claims are approved in accordance with documented authority limits. Review documentation of QA reviews to determine whether the QA function is being executed as outlined in the insurer's policies. On a sample basis, reperform the QA testing to ensure that the testing was completed accurately.	
Claims under claims-made liability policies are improperly accepted (or rejected) by the claims adjusters.	RP RV OP ST	AC CM	RD	The insurer has a policy in place whereby coverage is automatically triggered under claims-made liability policies when a claim is first made during the policy period (as long as it did not occur prior to the retroactive policy date specified). A QA review is periodically performed for each claims processor to ensure compliance with claims-handling policies	Perform a walkthrough to verify that the adjuster properly applies tail coverage to the claim and reallocates the claim to the correct policy year. Review documentation of QA reviews to determine whether the QA function is being executed as outlined in the insurer's policies. On a sample basis, reperform the QA review to ensure the testing was accurately completed.	Perform data validation testing to ensure that claims under claims-made liability policies are being properly administered.

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The claims data utilized by the actuary to estimate reserves does not correspond to the data in the insurer's claims system and to the data in the insurer's accounting records.	OP RV	AC CO	RD	The insurer has established procedures to reconcile actuarial data to the insurer's claims system, the data in the insurer's accounting records and appropriate annual financial statement schedules and/or exhibits. Such reconciliations are reviewed by supervisory personnel. Inventories of reported and unpaid claims are maintained and periodically reconciled to the general ledger.	Review the insurer's reconciliation reports of actuarial data to the insurer's claims system and the insurer's accounting records. Ensure evidence of supervisory review. Review the insurer's reconciliation of reported and unpaid claims to the general ledger.	Test reconciling items within the reconciliations for appropriateness. Reconcile the insurer's actuarial report for losses and loss adjustment expenses to supporting insurer reports, general ledger, and annual financial statement schedules and exhibits as of the valuation date.
Reinsurance is not properly taken into account in accumulating claims data.	RV	AC CO	RD	The insurer has established procedures to prepare the claims data for actuarial review in accordance with the insurer's reinsurance treaties.	Review the insurer's reconciliation reports of actuarial data to the insurer's claims system, reinsurance reports, and accounting records. Test the operating effectiveness of the insurer's established procedures to include loss data for assumed reinsurance treaties within the claims data for actuarial review.	Test reconciling items relating to reinsurance loss data for appropriateness. Verify assumed reinsurance loss data accumulated for actuarial review by comparing to the data provided by the ceding insurer for completeness.
Initial case reserves are not established or reviewed in accordance with the insurer's standards.	RV CR	AC VA CO	RA	The insurer has a case reserving philosophy, and qualified actuaries are involved in establishing and reviewing the reserving policy.	Obtain documentation supporting the insurer's reserving philosophy. Review the reserving philosophy for actuarial review and policy adequacy.	Review a sample of reserves, verify that the calculation is in accordance with the reserving philosophy and that reserves are calculated on a timely basis.

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				Initial reserves are made in accordance with the insurer's reserving philosophy and within a specified time frame. Claims adjusters/ supervisors are required to review significant initial case reserves on a timely basis and make adjustments as necessary. The insurer verifies that the TPAs that process claims follow the insurer's guidelines for setting case reserves on reported claims. Committees are formed to evaluate and negotiate claims involving catastrophic injuries, complex claims, unusual law, and large or unusual loss reserve determinations or settlements.	For a sample of loss reserves, determine whether loss reserve reviews were performed and documented in accordance with the insurer's policy. Obtain periodic new claims reports and verify the insurer reviews significant initial case reserves and makes adjustments, if necessary, in a timely manner. Obtain minutes and other meeting materials from the meetings of the committee to determine whether the committee provided oversight.	For a sample of reserves meeting the criteria to go to a claims committee, determine whether the reserves were referred to this committee.*
Case reserves are not updated accurately.	RV CR	CO VA	RA	The insurer has a policy requiring open claims to be reviewed regularly. When new information is received, case reserves are reviewed and adjusted, if necessary. The claims management system generates analyses or reports that identify reserve increases and decreases, an outstanding reserve list, an outstanding	From a sample of case reserves, determine whether the reserves were updated regularly and appropriately. Determine whether new information is received and whether the reserves are adequate and/or updated accurately.* Obtain copies of the reserve reports, noting management approval.	Select a sample of paid claims and compare the final overall claims settlement with the case reserve to determine whether the reserves are adequate and/or updated accurately.* Verify that the information contained in management reserve reports is accurate and complete and determine

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				reserve list by claims adjuster and a reserve release report. These reports are reviewed/ monitored by the claims manager for reasonableness.		whether the appropriate analysis is being used to evaluate the reserves.
The insurer is not properly recording case reserves (assumed or ceded) for contracts subject to reinsurance.	RV CR LG	EO VA AC	RA	The insurer has policies in place to verify that case reserves subject to reinsurance are valid and accurate (within contract time frame, covered under the contract, etc.).	Review the insurer's policies to determine appropriateness, noting management approval. Review documentation of the insurer's review of claim validity.	Utilize NAIC Examination Jumpstart reports to determine whether case reserves recorded by the insurer agree with the case reserves of the assuming (ceding) insurer.
The assumptions and methodologies used by the insurer are not accurate and appropriate.	RV	VA AC PD	RA	The insurer uses consistent assumptions and methodologies that have been based on historical results, to the extent appropriate, adequately documented, approved by senior management and in accordance with statutory accounting principles and applicable state statutes and/or regulations. Senior management uses internal or independent actuaries to conduct reserve analyses of all major lines of business on an annual basis. Actuarial analysis is subject to a peer review process. Management receives	Gain an understanding of the insurer's assumptions and methodologies and compare with prior periods. Verify that senior management signs off on assumptions and methodologies used by the insurer, including any changes. Verify separate management review reports from actuaries and that reports include reserve analyses for all major lines of business. If performed in-house, review and test the actuarial peer review process and related sign-offs. Verify management review	Review assumptions and methodologies for reasonableness, appropriateness and accuracy with assistance from the insurance department actuary or an independent actuary. Verify that reserving assumptions are in accordance with the relevant SSAPs related to P&C reserving, as well as applicable statutes, regulations, pronouncements and/or bulletins. Review prior history of loss development, as well as segregation of development data to analyze the reasonableness of assumptions and methodologies.

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				regular reports on loss ratios (including incurred but not reported (IBNR)) by line or class of business grouped by accident year and calendar year, as well as other key ratios, and reviews unusual fluctuations on a timely basis to review reserves for adequacy. The insurer utilizes a fully staffed, well-qualified actuarial function that is under the direction of a fellow (or associate) of the Casualty Actuary Society (CAS) and its experienced in the lines of business written by the insurer. The reserving actuarial unit's responsibilities are segregated from the pricing actuarial unit, but there is regular communication between the two units. The insurer's organizational structure limits the influence that management can have on the appointed actuary.	of loss reserve reporting and test the operating effectiveness of procedures in place. Review the credentials, background and responsibilities of the insurer's actuarial function (internal or external) for appropriateness. Request and review the insurer's organizational chart and job descriptions to determine whether the functions are separate and distinct. Interview the appointed actuary during the planning phase of the examination to determine whether the insurer's organizational structure is appropriate in this area.	Determine whether the appropriate disclosures have been made in the Notes to the Financial Statements for the changes in reserve methodologies. Review actuarial reports and compare reports to prior periods. Investigate significant variations. Utilize the insurance department actuary or an independent actuary to perform an independent calculation/estimate of the loss reserves. Review correspondence related to peer review for appropriate depth of review. Compare the opining actuary's assumptions and estimates with those in other available actuarial analyses. Determine whether the Actuarial Opinion was changed by the appointed actuary after meeting with insurer management.
Catastrophe-type (CAT) claims or large or significant exposure type claims data are not separately	OP RV	AC VA	RD RA	The insurer has established procedures to prepare the claims data for actuarial review by extracting CAT claims or large or	Test the operating effectiveness of the insurer's established procedures to prepare the claims data for actuarial	Coordinate detailed download of all claim transactions during the examination period. Utilize audit software to verify that

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identified and evaluated from other claims.				significant exposure type claims, for a separate reserve analysis.	review. Review the insurer's actuarial reserve analysis for incorporation of a separate review of CAT claims or large or significant exposure type claims.	claims data appropriately distinguishes CAT claims or large or significant exposure type claims and that these claims have been extracted from the general claims data and presented separately to the actuary.
Changes in the legal environment or changes in the insurer's underwriting, case reserving or claims-handling processes are not appropriately considered within the insurer's reserving assumptions and methodologies.	OP RV ST	VA PE AC	RA	The insurer has procedures in place for its legal department to monitor and communicate changes in the legal environment (e.g., changes in case law, award amounts, trends in the number of claims being litigated) and being taken into consideration by the reserving unit in a timely manner. The insurer has procedures in place for the underwriting, case reserving and claims-handling units to communicate changes in their processes to the reserving unit in a timely manner.	Review the insurer's process to monitor changes in the legal environment that may affect the reserving process. Review evidence of communication between the reserving unit and other relevant insurer units.	Through a review of the actuarial reports, determine whether changes in the legal environment or changes in the insurer's internal processes have been properly incorporated in the insurer's reserving assumptions and methodologies.
The loss and loss adjustment expense (LAE) reserve computations are not performed correctly or the selected estimates are unreasonable.	OP RV	AC VA	RA	The insurer has an established process (although assumptions and methodologies may change) to estimate the loss reserves on an annual basis. The insurer has established processes to estimate the defense and cost	Review the processes in place (which may include a performance of a walkthrough) to estimate the loss reserves. Review the processes (which may include a walkthrough) in place to	Utilize the insurance department actuary or an independent actuary to perform an independent estimate of the loss reserves. Utilize the insurance department actuary or an independent actuary to

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				containment (DCC) and the adjusting and other (AO) loss adjustment expense reserves on an annual basis. The insurer maintains a fully staffed, well-qualified actuarial department that is under the direction of a fellow (or associate) of the Casualty Actuary Society (FCAS) and is experienced in the lines of business written by the insurer. Senior management uses either internal or independent actuaries to conduct reserve analyses of all major lines of business on an annual basis. The actuarial calculations are subject to a peer review process. The insurer's board of directors (or committee thereof) receives an annual presentation on the actuarial analysis process. Management receives regular reports on loss ratios (including IBNR) by line or	estimate both the DCC and AO loss adjustment expense reserves. Review the credentials, background and responsibilities of the insurer's actuarial department staff for appropriateness. Obtain actuarial reports to verify insurer is using either independent or in-house actuaries to perform the reserve calculations on all major lines of business annually and verify senior management review of reports from actuaries. Perform and in-house, review and test the actuarial peer review process and related sign-offs. Review meeting minutes of the board of directors (or committee thereof) to verify that a presentation was given on the actuarial analysis process. Verify management review of loss reserve reporting and test the operating	prepare an independent estimate of LAE. Perform analytical procedures to review the reasonableness of loss reserve estimates.

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				class of business for accident year and calendar year, as well as other key ratios, and reviews unusual fluctuations on a timely basis to review reserves for adequacy.	effectiveness of procedures in place.	
The computation of reinsurance credits within loss reserves are not performed correctly. (See also Examination Repository – Reinsurance Ceding Insurer.)	CR RV	AC VA CO	RA	The reserving actuary calculates the reserve on a gross basis and determines the net basis by estimating the reinsurance credits and applying them to the gross reserve The [illegible] reinsurance [illegible] reserves by reviewing reinsurance treaties in pla[illegible] at the insurer, as well a[illegible] historical results.	Test the operating effectiveness of the insurer's process for reviewing the reserve analysis to determine whether loss reserves have been estimated on a gross basis, including management approval and sign-off. Test the operating effectiveness of the insurer's process to estimate reinsurance credits for loss reserves, including management approval and sign-off.	Compare the annual financial statement's net and gross incurred and paid loss presentation for consistency with reinsurance treaties in place at the insurer. Consider the reasonableness of reinsurance credits taken, based on a review of the insurer's reinsurance program and treaties in place. Utilize the insurance department actuary or an independent actuary to review the reasonableness of the ceded reinsurance estimates contained in the opining actuary's report.
Management books reserves that are materially different than the actuary's best estimate.	OP ST LG	VA PD	RA	The insurer has a process in place to ensure that reserves are recorded based on the actuary's best estimate, or documents an appropriate reason for any deviations. The board of directors (or committee thereof) reviews	Review management's guidelines regarding the recording of actuarially determined loss reserves Verify that deviations from the actuary's best estimate are properly documented, if applicable. Review meeting minutes of the board of directors (or	Review the actuarial report, as well as the annual financial statement and [illegible] appropriate documentation, to determine whether the [illegible]ter has booked the actuary's best estimate. Review the documentation supporting a deviation from

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				management's best estimate of booked reserves and challenges such estimates based upon reports received, including the actuarial report from the appointed actuary. The insurer's organizational structure limits the influence that management can have on the appointed actuary.	committee thereof) minutes for evidence of a presentation and review of information supporting management's best estimate of the booked reserves (i.e., the actuarial report). Interview the appointed actuary during the planning phase of the examination to determine whether the insurer's organizational structure is appropriate in this area.	the actuary's best estimate for reasonableness, if applicable.
The insurer does not maintain an adequate premium deficiency reserve.	RV RQ OP	VA CO CM	RA	The insurer has a process in place to review for premium deficiencies on an annual basis in accordance with SSAP No. [illegible]. Independent actuarials review and sign off on deficiency reserve calculations.	Review the process in place and verify key controls surrounding the calculation of premium deficiency reserves. Obtain the actuarial opinion and verify approval of deficiency reserve calculations.	Perform an analytical review of loss ratios. If necessary, utilize the insurance department actuary or an independent actuary to perform a detailed review or an independent calculation/estimate of the premium deficiency reserves.

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EXAMINATION REPOSITORY – UNDERWRITING

Annual Statement Blank Line Items

There are no Annual Statement line items directly related to the underwriting process; however, policies underwritten and rate calculations may impact line items associated with areas such as premiums and reserves.

Relevant Statements of Statutory Accounting Principles (SSAPs)

All of the relevant SSAPs related to the underwriting process, regardless of whether or not the corresponding risks are included within this exam repository, are listed below:

No. 6 Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due from Agents and Brokers (*All Lines*)
No. 51R Life Contracts (*Life Companies*)
No. 53 Property Casualty Contracts – Premiums (*P&C Companies*)
No. 54R Individual and Group Accident and Health Contracts (*Health Companies*)
No. 65 Property and Casualty Contracts (*P&C Companies*)

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Other Than Financial Reporting Risks						
The insurer has not developed and followed its overall underwriting strategy.	ST PR/UW OP	Other	UPSQ	The underwriting strategy indicates the types and lines of business (coverages), geographical areas and other rating classes the organization seeks to write in. The overall underwriting strategy is reviewed, monitored and approved by the board of directors on a regular basis. The underwriting department has established and documented goals in accordance with the insurer's overall underwriting strategy. The insurer reviews its underwriting performance to identify non-compliance with its underwriting strategy.	Review documentation demonstrating that the insurer has developed a formal underwriting strategy. Review board minutes and/or packets for evidence that the board actively reviews and/or approves the insurer's underwriting strategy on a regular basis. Review the underwriting department's goals for compatibility with the insurer's overall underwriting strategy. Review the insurer's process to monitor compliance with underwriting strategy and determine if non-compliance is appropriately remediated.	Review the insurer's underwriting strategy for appropriateness. Review the information provided within underwriting reports reviewed by management and the board for accuracy and appropriateness. Review historical premium written detail as well as underwriting and profitability results and determine whether the underwriting strategy is being followed.
The insurer has not established and maintained appropriate risk exposure limits (including catastrophe coverage) that are consistent with risk	ST PR/UW	Other	UPSQ	The insurer has established and documented risk exposure limits by geography, other rating classes and line of business (coverages) that have been reviewed and approved by senior management.	Review documentation of risk exposure limits and evidence of senior management review/approval. Consider if the risk limits are consistent with the risk appetite and risk tolerance	Utilize audit software to review the insurer's risk exposure reports for compliance with limits. (For P&C companies, summarize policies by NAIP code, industry code, policy size, etc.; for life and health

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appetite.				Risk exposure limits established by the insurer consider the direct and indirect impacts of climate change risk. The insurer utilizes a fully staffed, well-qualified underwriting function that has experience in all lines of business (coverages) and geographic locations (rating classes) serviced by the insurer. The insurer utilizes risk models to track compliance with exposure limits established by the insurer.	levels articulated in the company's ERM process and consider alignment with the company's reinsurance program. Perform a walkthrough of the underwriting process and observe how the impact of climate change risk is considered when establishing risk exposure limits. Review the credentials, background and responsibilities of the insurer's underwriting function (internal and/or external). Test the operating effectiveness of the insurer's controls to track compliance with the exposure limits by reviewing modeling data	companies, summarize by risk class, age, medical codes, etc.) for compliance with insurer limits. If the insurer has not identified risk exposure limits, test the risk exposures for appropriateness by considering applicable industry standards and comparison to peer groups. Perform detailed review of risk exposure models and management reports to monitor exposure by risk. Areas to consider include accuracy and completeness of input data, reasonableness of methodology and results as well as management discipline in adhering to risk exposure limits.
The insurer has not established sufficient pricing practices, resulting in inadequate or excessive premium rates in relation to its assumed risks and expense structure. Consider utilizing an	ST PR/UW	Other	UPSQ	The insurer has developed comprehensive pricing practices that have been approved by senior management. Pricing practices include consideration of future changes in loss	Review documentation of pricing practices and evidence of senior management review/approval. Perform a walkthrough of the pricing process and observe how the impact of	Review the underwriting pricing guidelines established by the insurer for appropriateness. Perform analytical procedures to review the insurer's profitability and history of indicated rates vs.

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
actuarial specialist to assist with test procedures related to this risk.				development including the impact of climate change risk. The insurer utilizes a fully staffed, well-qualified pricing actuarial function that has experience in all lines of business (coverages) and geographic locations (rating classes) served by the insurer. The pricing actuarial function has an established process to calculate base premium rates based on historical loss results, trends, principal advisory organizations (ISO, LIMRA, etc.) and/or other appropriate factors (e.g., costs of reinsurance, expense structure, commission rates) and the calculation is subject to a peer-review process. Regulatory changes are factored into pricing decisions.	claim trends including climate change risk and weather variability is considered when establishing rates/prices. Review the credentials, background and responsibilities of the insurer's pricing actuarial department for appropriateness. Perform a walkthrough to gain an understanding of the rate calculation process, and obtain evidence of a peer review of base premium rate calculations and possibly get input from line personnel. Perform a walkthrough of the company's pricing process and observe how regulatory changes are factored into pricing decisions.	selected/filed rates to evaluate the sufficiency of premium rates. If rates have been subject to insurance department approval, consider whether reliance can be placed on this work. If deemed necessary, utilize the insurance department actuary or an independent actuary to perform a review or independent calculation of base premium rates. Compare base premium rates utilized by the insurer to industry averages and advisory organization recommendations for reasonableness.
Policies are issued that do not comply with	OP PR/UW	Other	UPSQ	The insurer utilizes a fully staffed, well-qualified	Review the credentials, background and	Test a sample of new policies underwritten to

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
underwriting and pricing guidelines				underwriting function that has experience in all lines of business (coverages), geographic locations and other rating classes served by the insurer. The insurer provides initial and ongoing training programs to qualify its underwriting staff to follow the insurer guidelines established. Underwriters are restricted in the type and amount of policies that they underwrite by authority levels built into the system. The insurer has established a QA process to review policies underwritten for compliance with underwriting guidelines on a sample basis. The insurer designates an individual to be responsible for tracking and maintaining licenses for all jurisdictions in which it transacts business. The insurer has a process in place that requires deviations from pricing or acceptability guidelines to	responsibilities of the insurer's underwriting function (internal and/or external). Review documentation outlining the insurer's training of underwriting staff. Test the operating effectiveness of automated controls (i.e., authority levels) through reperformance and observation. Re-perform, on a sample basis, testing of policies reviewed by the QA function for proper implementation of the insurer's underwriting guidelines. Review the insurer's process for tracking and maintaining licenses to write business. Review the insurer's process for reviewing deviations from pricing or acceptability guidelines.	determine whether the final underwriting decision (including any deviations from accepted guidelines) was made by someone at an appropriate authority level.* Test a sample of new policies underwritten for compliance with appropriate underwriting guidelines.* Test a sample of new policies underwritten for appropriate pricing. Review certificates of authority for the states and jurisdictions where the insurer is licensed to write business as of the examination date.

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				be pre-approved, reviewed, and/or spot-checked.		
Underwriting results are not monitored and updated in order to measure success or failure of business written.	PR/UW ST	Other	UPSQ	A portfolio manager analyzes key portfolio indicators—such as policies in force, new policy count and policy retention—on a monthly, quarterly and annual basis. Actual policy in force counts are compared to the annual policy in force goals to assess the growth or decline in portfolio size. The company measures underwriting results and key policy characteristics at specific intervals to uncover unexpected relationships between policy characteristics, variances from pricing assumptions or other factors that may affect portfolio performance. The company has a process in place to take corrective actions to address product and underwriting problems identified in the portfolio.	Review company reports to determine sufficient oversight of the company's portfolio. Verify management oversight and approval of the measures used to assess underwriting results and variances from pricing assumptions and of the periodic reports used for monitoring portfolio performance. Review underwriting department's underwriting file review process and management's use of results to drive performance and compliance with company goals and direction. Verify the company has implemented changes to underwriting guidelines to address policies with	Review underwriting results for profitability. Consider profitability from a variety of perspectives, including product lines, geographic areas and distribution channels. Discuss any significant variances or discrepancies between planned strategies/budgets/pricing assumptions and actual results with senior management.

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
					unanticipated loss exposures.	
The insurer has developed or implemented marketing or distribution plans that are not feasible or consistent with its business and underwriting strategy.	OP PR/UW	Other	UPSQ	The insurer has established and maintains clear and reasonable goals and objectives regarding marketing and distribution plans (i.e., direct, online, agency network, app, etc.) to achieve its underwriting strategy. Marketing and distribution plans are reviewed and updated on a regular basis to account for changes in the marketplace and consumer preferences. The insurer has cross-unit meetings prior to product roll out and periodically thereafter on all product lines to ensure business decisions are aligned across units/departments and changes are communicated in a timely manner	Review the marketing and distribution plans and obtain evidence of management approval. Determine if the insurer periodically evaluates its marketing and distribution plans and updates the plans, if necessary, to address changes in the marketplace and effectively execute the underwriting strategy. Review evidence of cross-unit communication and consider the frequency and depth of communication in evaluation of the company's control.	Review marketing and distribution plans and compare with underwriting strategy to determine if there are inconsistencies. Consider if there are inconsistencies with other information filed with the department (e.g. business plan, ORSA, risk registers, etc.). Review the company's marketing and distribution plans for feasibility and appropriateness in light of market conditions and competition. Review company's ongoing performance against projections to evaluate the effectiveness of the company's marketing and distribution efforts.
The insurer does not effectively oversee its producers, including managing general agents (MGAs) and third-party administrators (TPAs), to ensure that appropriate underwriting and	OP RP PR/UW	Other	UPSQ	The insurer has developed comprehensive underwriting, pricing and premium processing guidelines and practices that have been approved by senior management and communicated to the MGAs and TPAs.	Review documentation of underwriting, pricing and premium processing guidelines and practices for evidence of senior management review/approval, as well as evidence of communication and training provided to the MGAs and TPAs.	Perform analytical procedures to review the underwriting and premium processing results of significant MGAs and TPAs. If deemed necessary, perform onsite visit to examine the underwriting

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
premium processing standards are not practiced.				The insurer monitors the underwriting and premium processing results of its MGAs/TPAs through a regular review of relevant ratios. The insurer requires a Type II SOC 1 report be issued for the service provider and reviews annually.	Review documentation that provides evidence of regular review of MGA/TPA underwriting and premium processing results by the insurer. Review the service provider's audited financial statements and Type II SOC 1 report to determine the service provider appears to have a solid financial position and appropriate internal controls. Review any audit reports and other documentation to determine whether the insurer provides sufficient oversight of its MGAs/TPAs.	and premium processing functions at the MGA/TPA.
Financial Reporting Risks						
Policy data are not properly and completely entered into the system.	OP PR/UW	AC CO	UPSQ RA	The insurer's system contains edit checks that require policy data to be complete and reasonable before being entered into the system. The insurer has a QA process in place that tests policy data entered into the	Test the operating effectiveness of edit checks through reperformance or observation. Re-perform, on a sample basis, QA testing of the application data entered into	Trace a sample of records from the policy data to the database and from the database to the policy data to verify and validate key data elements used in the database. Trace a sample of records from an external source

[1] For Life companies, consider performing this test in conjunction with testing performed in the Examination Repository Reserves (Life) which often include similar data elements.

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				system on a sample basis.	the system.	(i.e., bank deposits) to the policy database to ensure all policies are properly recorded in the system.
Policies are underwritten with high deductibles that expose the company to significant collectibility/credit risk.	ST PR/U CP	Other	UPSQ	The insurer reviews the credit quality of potential policyholders before underwriting high-deductible policies. The insurer requires collateral to be posted and maintained to ensure that deductibles on significant claims can be collected. Collateral levels and associated claims activity are reviewed on a regular basis to ensure collectibility.	Review evidence of credit assessment prior to the approval of high-deductible policies. Obtain evidence of the insurer's process to require and maintain collateral at a sufficient level for high-deductible policies.	Consider reviewing a sample of high deductible policies and evaluate sufficiency of collateral based on ongoing claims activity and credit risk of the insured. Perform an analytic to review and assess historical collections. Review the quality/liquidity/availability of collateral held for high deductible policies.

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SECTION 4 – EXAMINATION EXHIBITS

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EXHIBIT A
EXAMINATION PLANNING PROCEDURES CHECKLIST

COMPANY NAME_____

PERIOD OF EXAMINATION _____

The following checklist details the components of Phase 1 and Phase 2, as well as other information that should be considered during the planning process. Narrative guidance is provided within Section 2 of this Handbook to aid examiners in understanding the risk-focused surveillance process.

Examiner	Date

Pre-planning Procedures

1. At least six months prior to the as-of date, notify the company and its external auditors, with company personnel's assistance, that an examination will take place and that the auditor workpapers will be requested when the exam begins.

2. If the examination is to be performed on a company that is part of a holding company group, send an informal notification at least six months prior to the as-of date to other states that have domestics in the group.

3. Call the examination in the Financial Exam Electronic Tracking System (FEETS) at least 90 days prior to the exam start date.

    a. If the examination is to be performed on a company that is part of a holding company group, document your attempts to coordinate the exam with the Lead State and other domestic state(s) within your group. Utilize Exhibit Z – Examination Coordination to assist with this process.

4. Send preliminary information requests to the company with sufficient lead-time to allow information to be provided prior to the start of examination fieldwork. Exhibit B – Examination Planning Questionnaire and Exhibit C, Part One – Information Technology Planning Questionnaire can be utilized to assist in developing pre-planning requests. **Note**: The examiner is encouraged, with input from the financial analyst when possible, to customize Exhibit B to the insurer being examined prior to submitting the information request.

Phase 1 – Understand the Company and Identify Key Functional Activities to be Reviewed

Part 1: Understanding the Company

Step 1. Gather Necessary Planning Information

Meet with Financial Analyst

1. Meet (in person or via conference call) with the assigned financial analyst (and/or analyst supervisor) to gain an understanding of company information available to the department. In addition, discuss risks and concerns highlighted in the Insurer Profile Summary as well as the company's financial condition and operating results since the last

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examination. Ascertain the reasons for unusual trends, abnormal ratios and transactions that are not easily discernible. Document a summary of significant risks identified by the analyst for further review on the examination. **Note**: An email exchange, in and of itself, is not deemed sufficient to achieve the expectation of a planning meeting with the assigned analyst.

a. If deemed necessary, obtain supporting documentation from the most recent annual financial statement analysis to aid in the identification of significant risks and facilitate ongoing discussion with the analyst.

Obtain Existing Documentation

2. Obtain copies of relevant information available to the insurance department as deemed necessary to aid in the identification of significant risks. (**Note:** Review of these documents may have already been performed by the analysis unit, while other documents may already be available on I-Site+ in accordance with NAIC general filing deadlines and requirements.) Such information may include but is not limited to:

a. Annual financial statements.

b. Previous examination report and supporting workpapers.

c. Market conduct report (if deemed applicable).

d. CPA financial statement audit report.

e. Actuarial opinion.

f. Independent loss reserve analysis report, if done.

g. Management's discussion and analysis letter.

h. Risk-based capital (RBC) report.

i. Holding company registration statements.

j. SEC registration statements, most recent 10-K and 10-Q.

k. CPA audit of internal control over financial reporting (SOX) report.

l. Examination Jumpstart reports.

m. IRIS reports.

n. Department's correspondence file.

o. Inter-divisional memorandum.

p. NAIC database reports (RIRS, CDS).

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q. Credit rating agency reports.

r. Articles of incorporation, bylaws and amendments.

s. Recently approved agreements or contracts (e.g., expense-sharing agreements, assumption reinsurance contracts, custodial agreements, etc.).

t. Form F – Enterprise Risk Report.

u. Own Risk and Solvency Assessment (ORSA) summary report.

Obtain Additional Information

3. Use the understanding of company information already available to the department to determine what additional information is necessary to assist in examination planning. Develop customized information requests to obtain additional information from the company to assist in exam planning, as necessary.

Assess the Effects of External Environmental Conditions

4. Assess the effects of external environmental conditions and factors. Focus on conditions which affect the company's operations, primary lines of business and investments. Examples include recent regulatory developments, industry climate, competition in the marketplace, recent market entrants, etc. As part of this assessment, examiners should consider the NAIC Solvency Monitoring Risk Alert and/or the AICPA Audit Risk Alert.

Identify Significant Accounting and Reporting Issues

5. Identify significant accounting and reporting issues affecting the examination. Consider the impact of changes in the NAIC *Accounting Practices and Procedures Manual*, *Annual Statement Instructions*, statutes and department rulings. Also consider company departures from statutory accounting principles, permitted practices, significant accounting transactions (e.g., loss portfolio transfers, financial reinsurance, assumption reinsurance, loss reserve discounting) and new types of investments (e.g., derivatives, private placements, etc.).

Meet with Other Department Personnel

6. Meet with the in-house actuary to discuss the company's historical reserving issues and extent of data validation required.

7. Meet with the chief examiner or designee to discuss:

a. Planning materiality and the preliminary examination approach.

b. The possible use of a specialist (e.g., actuary, information systems, investment, appraiser, IT examiner, reinsurance expert). If applicable, prepare "request for bid" letters, or similar

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documents, for the use of a specialist.

c. Significant events (e.g., pending merger/acquisition) and department concerns.

d. Impact of conditions present in the industry and economy relative to the examination plan.

e. Staff experience requirements.

f. Relationship with the internal and external auditors.

Contact Other Regulators

8. When conducting an exam of an insurer that is part of a holding company group that includes a company (or companies) that are at least in part regulated by regulators outside of the state insurance regulatory structure, contact the appropriate state, federal and international regulators to determine areas of concern for the group that should be addressed during the exam.

Meet with Company Representatives

9. Meet with company personnel to discuss relevant examination issues such as the following:

a. Significant changes in the company's operations, major lines of business and corporate governance.

b. Personnel or systems changes that would significantly affect the areas of accounting controls, procedures, systems or approval authorities. The same inquiries should be made of the electronic data processing (EDP) department and the internal audit department's procedures and scope.

c. Scheduling a meeting with the external auditor to review the financial statement audit workpapers and any Sarbanes-Oxley workpapers.

d. Plans for scheduling interviews with key members of management.

e. Whether the company outsources critical business functions to third parties. **Note:** If the examiner determines that the insurer outsources critical functions to third parties, additional consideration and test procedures may need to be performed during the IT review and during control and substantive testing phases of the examination.

10. Follow-up on requests for additional required reports and records (if necessary).

11. Obtain relevant internal audit reports for review and consideration.

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12. Request trial balance and other accounting records used to prepare annual financial statements.

13. If required based on anticipated risk-assessment, request pertinent information to confirm investment and bank accounts.

14. Discuss relationship with the internal and external auditors.

Meet with the Company's Appointed Actuary

15. Arrange a meeting with the appointed actuary to review the objectives and scope of the actuary's work and to obtain an understanding of the methods and assumptions used in establishing the actuarially determined asset or liability. Consider:

    a. The materiality and risks (e.g., nature and type of business, loss development, reinsurance, etc.) associated with the accounts.

    b. The actuaries' professional qualifications (e.g., FCAS or ACAS for casualty insurance), reputation and relationship with the insurer.

    c. Any changes in methodology or assumptions from the prior examination.

    d. The actuaries' interaction with the internal and external auditors.

    e. Any changes to the reserving platform (i.e., computer program) since the prior examination.

Consideration of Fraud

16. Complete planning procedures for the consideration of fraud utilizing Exhibit G – Consideration of Fraud (or similar document).

Consideration of Related Parties

17. Obtain relevant information to assist in identifying related party relationships and transactions (e.g., identify parent, affiliates, subsidiaries and ultimate controlling person, principal owners, large shareholders, board of directors, officers, etc.). **Note:** Review of this information may have already been performed by the department analyst.

Step 2. Review of Gathered Information

18. Utilizing the gathered information, obtain an understanding of the company's business and corresponding risk exposures. Exhibit CC – Issue/Risk Tracking Template (or similar document) should be used to accumulate significant risks or issues identified through the review of information gathered.

19. Prepare a time budget and allocate work assignments for the examination

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and obtain the chief examiner or designee's approval.

Step 3. Analytical and Operational Reviews

20. Perform high-level analytical and operational reviews directed toward overall financial condition and profitability of the company. The examiner should leverage the NAIC Financial Profile Report and rely on work previously performed by the analyst when possible. Exhibit F – Analytical Review Procedures provides additional guidance that can be utilized in conducting analytical and operational reviews.

Set Planning Materiality Levels

21. Based on the preliminary analytical review and understanding of the company's business, determine planning materiality and tolerable error.

Step 4. Consideration of Information Technology Risks

22. Utilize Exhibit C, Part Two – Evaluation of Controls in Information Technology (IT) Work Program (or a similar document) to assist in conducting the review and assessment of IT General Controls.

23. Review the IT examiner's assessment of the effectiveness of the company's IT general control (ITGC) environment and the impact of IT findings (if any). Consider whether IT risks have been sufficiently mitigated to allow for testing of application controls in Phase 3. If the ITGC environment is not effective, the examiner would be required to perform additional testing in later phases of the exam before relying on system generated reports or controls in place at the insurer.

Step 5. Update the Insurer Profile Summary

24. Provide updates to the analyst regarding any significant initial findings for incorporation into the Insurer Profile Summary. Updates to the Insurer Profile Summary can be suggested throughout the examination process.

Part 2: Understand the Corporate Governance Structure

1. Conduct interviews with key members of management, members of the board of directors and/or audit committee of the insurer, as well as any other employees deemed necessary.

2. Document an understanding and assessment of the insurer's corporate governance framework by considering the information included in Exhibit [illegible] Understanding the Corporate Governance Structure to address each of the following significant categories:

    a. Board of directors

    b. Organizational structure

    c. Assignment of authority and responsibility

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d. Management

e. Risk-management function (for ORSA companies, complete the ORSA Documentation Template found in Section 1, Part XI).

Part 3: Assessing the Adequacy of the Audit Function

Meet with Internal and External Auditors

1. Conduct a meeting with the external auditors to review both the financial statement audit workpapers and any Sarbanes-Oxley workpapers to discuss the scope of the audits (e.g., materiality, risk assessment and significant accounts/processes).

   a. Review relevant prior year audit workpapers if current year audit is in progress.

   b. Review pertinent management letters.

2. Utilize Exhibit E – Audit Review Procedures, to assess the adequacy of internal and external audit functions.

Part 4: Identifying Key Functional Activities

1. Determine key functional activities (e.g., premiums, claims, investments) by considering information gathered to this point. The insurance organization may be examined on the same basis as it manages risk and controls itself, so key functional activities should typically correspond organizationally to the insurer. Consider discussing proposed key functional activities with the company before making final determinations. Complete applicable documentation for those activities determined to be significant.

Part 5: Consideration of Prospective Risks/Indications of Solvency Concerns

1. Based on the preliminary analytical review, input from the analyst and the knowledge and understanding of the company, identify prospective risks that may indicate potential future solvency concerns for the company.

2. Determine where the prospective risks identified will be addressed. For broad prospective risks that impact more than one key functional activity, post the risks to Exhibit V – Overarching Prospective Risk Assessment for review. For risks that are directly associated with a particular key activity, post the risk to that activity's risk matrix for review.

Phase 2 – Identify and Assess Inherent Risk in Activities

1. Identify and assess inherent risks for key activities using a risk assessment matrix or similar tool. Consider both financial reporting risks and other than financial reporting risks in this process.

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2. Ensure that each inherent risk identified should be associated with at least one of the nine branded risk classifications identified in Exhibit L – Branded Risk Classification.

3. Complete Exhibit CC – Issue/Risk Tracking Template by verifying that each item has been linked to a risk statement on a key activity matrix or Exhibit V – Overarching Prospective Risk Assessment or by documenting that additional work is not deemed necessary.

4. Complete Exhibit DD – Critical Risk Categories to determine whether all relevant critical risk categories have been included/considered on a risk matrix. In situations where a particular critical risk category is not addressed by at least one risk statement, the exam team should explain, in the planning memorandum, the rationale for why a critical risk category is not considered applicable to the company under exam.

5. Complete the planning process, including Exhibit I – Examination Planning Memorandum.

6. Obtain the chief examiner's or designee's approval of planning documentation, including Exhibit I – Examination Planning Memorandum, before control and detail testwork is performed.

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EXHIBIT B
EXAMINATION PLANNING QUESTIONNAIRE

The Examination Planning Questionnaire contains procedures and questions that are designed to assist the examiner in gathering necessary planning information and obtaining an understanding of the insurer's organization. The examiner or company personnel should complete this questionnaire as early in exam planning as practical. If company personnel complete this exhibit, identification of who completed each request, as well as supporting documentation, should be provided to the examination team, and the responses to this questionnaire should be critically evaluated by the examiner. If information requested through the questionnaire has already been provided to the department, the company's response should so state and reference when and how the information was provided. The substance of the information collected during the completion of this questionnaire should be incorporated into the Examination Planning Memorandum. The questionnaire responses should be considered when identifying the inherent risks of the insurer. They should also affect the planned examination approach, as well as the nature, timing and extent of examination procedures performed.

Examiners may consider requesting the completion of Section K – Liquidity during interval outside of the full-scope examination period (e.g., annually). Most questions in this section are intended for all insurers. However, questions 9, 10 and 11 in this section apply to life insurers only. Therefore, the questionnaire should be customized before it is provided to the insurer. If the examiner has prior knowledge or reason to believe the company may be facing significant liquidity risks, the additional liquidity tables included at Attachment 1 may also be requested to prompt the company to provide greater detail regarding potential liquidity risks (typically most applicable to life insurers). Alternatively, if the examiner is not already aware of significant liquidity risks, it may be appropriate to first review the company's responses to the liquidity questions before determining whether the additional detail provided by the tables should be gathered.

If the company's state of domicile has adopted the *Corporate Governance Annual Disclosure Model Act* (#305) and *Corporate Governance Annual Disclosure Model Regulation* (#306), the following information may have been provided via the Corporate Governance Annual Disclosure (CGAD) filed with the insurance department. If the CGAD is available to the examiner, Section IA – The Board of Directors and its Committees and Section VI – Code of Conduct may be removed from the questionnaire prior to providing to the company for completion.

Customization of Questionnaire Prior to Distribution

This questionnaire should be customized to the insurer being examined to allow the examiner or company personnel completing the questionnaire to focus only on the applicable questions. The questions that remain should be completely addressed, providing additional support if necessary. It is possible that the financial analyst has performed work in these areas as part of the analysis procedures. Therefore, prior to completion of the questionnaire, the exam team should communicate with the analyst to determine whether the information has already been obtained in order to reduce duplication of work and duplicative information requests to the insurer.

To assist the exam team in identifying information that may already be provided to the department, requests that may be collected through the financial analysis process have been denoted with an asterisk (*) for ease in identification and potential removal from the questionnaire.

Instructions for Completing Exhibit

Please provide the most current version of the following items to the examination team within the specified timeline. If a requested item has already been provided to the department, please note the date and to whom it was provided.

	COMPLETED BY	SUPPORTING DOCUMENTATION
I. OWNERSHIP AND MANAGEMENT INFLUENCES		
A. The Board of Directors and its Committees The purpose of this section is to gather information related to the		

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	COMPLETED BY	SUPPORTING DOCUMENTATION
insurer's board of directors and its committees, including the audit committee.		
1. Provide documentation describing the makeup of the board of directors, including number of directors, affiliations of outside directors, relationship of each director to the organization and number of years as a director. If biographical summaries are available for the directors, these should also be included. Include information on board members who served at any time during the period under examination.*		
2. Provide information on the audit committee. This information should include:		
a. The number of members who serve on the committee.*		
b. The names of the members of the audit committee who could qualify as financial experts, in that they hold an accounting certification (CPA, CFE, etc.) and have previously been employed in a financial oversight role		
c. The number of members who are not part of company management and do not have business relationships with the company.*		
d. How often the committee meets		
e. Whether each member of the audit committee is a member of the board of directors and considered independent. (Independent members are individuals who are not part of company management and who do not have business relationships with the company.)*		
f. Whether the audit committee has an established charter. If so, provide a copy.		
g. Whether minutes of meetings are prepared and retained.		
3. Provide the excerpt from the articles of incorporation and bylaws that provides a description of the duties assigned and performed by the board of directors, its audit committee and any other committees of the board. Include a current list of committees and the members as of the examination date.*		
Provide an inventory of policies promulgated (and in effect as of 12-31-XX) by the board and its committees for oversight of the insurer, and describe how compliance with these policies is reported on by management.		
5. Describe the following board activities, and provide		

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	COMPLETED BY	SUPPORTING DOCUMENTATION
supporting documentation:		
a. How does the board monitor professional ethics and independence from issuers of audit reports?		
b. How does the board consult with external auditing firms on accounting and auditing questions?		
c. How does the board supervise audit work (internal and external)?		
d. How is the board involved with the oversight of the hiring, professional development and advancement of personnel?		
e. To what extent is the board responsible for the acceptance and continuation of audit engagements?		
6. Describe the following audit committee activities and provide supporting documentation:		
a. To what extent is the committee responsible for approving all audit and non-audit services provided by the company's issuer of audit reports?		
b. To what extent is the committee responsible for establishing procedures for the receipt, retention and treatment of complaints received by the company regarding accounting, internal controls or auditing matters?		
c. To what extent is the committee responsible for establishing procedures for the confidential, anonymous submission by employees of concerns regarding questionable accounting or auditing matters?		
d. Which member(s) of the committee is a financial expert?		
B. Corporate Planning		
1. Advise whether the company has developed a long-term strategic plan. Summarize the company's business strategy, if applicable, and provide the following information:		
a. How often are the strategic and business plans reviewed and updated?*		
b. How does management obtain and use information to stay abreast of changes in the competitive, technological and regulatory environments? What resources are used?		

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c. What is the scope of the established compliance and ethics program and how does it integrate with the company's overall business strategy?		
d. How is the strategic plan affected by the company's risk management practices?*		
i. How are risks accumulated and addressed?*		
ii. Does the company have an impact of climate change risk strategy? Have any risks been identified related to the impact of climate change risk and, if so, what are they and how are these risks incorporated into the company's overall business strategy?*		
C. Use of Specialists		
1. List any key consultants (e.g., actuarial specialist, investment manager, etc.) whose services were used during the examination period. State the specialist's relationship, if any, to the company, and the applicable reporting structure (i.e., to whom the specialists' reports are provided, to whom the specialist(s) have access, etc.).		
D. Culture		
1. Provide the company's formal mission statement, noting the elements regarding compliance, ethics and values.*		
2. How does the board and management set the "tone at the top" and communicate compliance, ethics, values, mission and vision?		
3. Discuss how employees and other stakeholders understand that the organization is serious about its compliance and ethics responsibility.		
II. ORGANIZATIONAL AND PERSONNEL PRACTICES		
A. Organization		
1. Provide details of the company structure, including:		
a. To the extent the corporate structure chart (by legal/business unit) has changed since the last annual statement filing, please provide the latest structure chart available.*		
b. Personnel organization chart.*		
c. Organizational chart detailing the structure of key business activities, including the individuals responsible for each activity, areas of responsibility and lines of		

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	COMPLETED BY	SUPPORTING DOCUMENTATION
reporting and communication.		
d. A list of critical management and operating committees and their members.		
2. Provide a copy of the formal conflict of interest policy. Provide information on the following elements regarding the conflict of interest policy:		
a. Does the conflict of interest policy require periodic declarations by officers, directors and key employees?		
b. Describe the system used to monitor compliance with the conflict of interest policy.		
c. What position in the organization provides oversight and leadership in the compliance/ethics function, and where does this position fall in the organization chart?		
3. Does the company have a written corporate governance framework? If so, describe how the corporate governance framework meets factors a–h below. (Note that similar to Section I.B above, if the examiner has access to the CGF, this question may be removed from the questionnaire prior to providing to the company for completion.)		
a. Approved and overseen by the board of directors		
b. Implemented and monitored by executive management.		
c. Aimed at the identification and fulfillment of sound ethical, strategic and financial objectives.		
d. Supported by business planning and resource allocation.		
e. Built by reliable business planning and proactive resource allocation.		
f. Reinforced by firm adherence to sound principles of segregation of duties.		
g. Independent review assessment of these programs. Is the assessment of these programs performed by the internal audit and/or by the independent certified public accountants?		
h. Objective in reporting of findings to the board or appropriate committees thereof.		
B. Personnel		
1. Describe the investigation of backgrounds and references during the recruitment and selection process for new employees		

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in the administrative and financial areas.		
2. Describe any significant turnover in management.*		
3. For each member of the company's key management, please provide:		
a. The member's length of service with the company, as well as length of service in his/her current position.*		
b. The member's specific industry experience.*		
c. The member's biographical information.*		
4. How are personnel policies—including hiring, evaluation and termination—documented and communicated to employees?		
5. Are employees who handle cash, securities, and other valuable assets bonded? List those covered, the amount of coverage and deductible.		
6. Are any related persons employed within the company? If yes, provide their names, job titles and relationship.		
7. To what extent is rotation of duties enforced by mandatory vacations? Explain.		
8. To what extent is job performance periodically evaluated and reviewed with each employee?		
9. To what extent are there formal training programs for administrative and financial personnel? Provide documentation describing the training provided.		
10. Describe the organizational structure of your compliance and ethics management team.		
11. How often, and by what methods, does management communicate the mission and vision of the compliance and ethics program to employees and other stakeholders?		
III. INTERNAL AUDIT ACTIVITIES AND INTERNAL CONTROLS		
A. Use of Internal Audit Departments		
1. To what extent are internal audit departments used?		
2. Is the scope of internal audit activities planned in advance with senior management, the board of directors or the audit committee? If so, which? If activities are planned with senior management, describe how the internal audit department remains independent.		

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3. To what extent do internal auditors prepare and follow written audit programs? How do these programs:		
a. Provide objective, independent reviews and evaluations of insurer activities, internal controls and management information systems?		
b. Help maintain or improve the effectiveness of insurer risk management processes, controls and corporate governance?		
c. Provide reasonable assurance about the accuracy and timeliness with which transactions are recorded and the accuracy and completeness of financial regulatory reports?		
4. Provide documentation describing the normal duties of the internal auditors, including the extent of financial audits and operational audits. Include the following information:		
a. Size and organization of the staff (including ratio of supervisors to staff).		
b. Prior experience of staff members.		
c. Number of CPAs and CFAs.		
d. Scope restrictions. If any, consider internal auditors' independence from management.		
5. Do internal auditors have direct access to:		
a. Senior management?		
b. Board of directors?		
c. Audit committee?		
d. Appropriate executives?		
6. How are responses to internal audit recommendations communicated and documented?		
7. How is the implementation of internal audit recommendations monitored?		
Are there training programs for internal auditors? Describe the training programs available for internal auditors, as well as any established continuing educational requirements.		
9. Are any internal auditors or members of their families related to other employees? If so, explain.		

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IV. MONITORING PROCEDURES		
A. Budgets		
1. Does management develop an annual budget and financial plan based on corporate goals and objectives? If so, please provide.*		
2. How are budget expectations communicated to those affected?		
3. Are estimates included in financial data and statements reviewed by knowledgeable persons independent of the estimation process? If yes, who performs this review?		
a. Are the entries supported by explanation and/or documentation?		
4. How is financial performance and the status of the company's financial condition periodically reviewed and/or compared to the budget and prior year?		
a. Are variances between budget and actual results explained by management?		
b. Are variances between prior and current year explained by management?		
c. How often are these analyses performed?		
5. To what extent do budgeting procedures cover all subsidiaries and departments?		
B. Financial Planning and Reporting		
1. Provide documentation summarizing the qualifications of key employees responsible for the preparation and issuance of financial statements. Include names, titles, job responsibilities, background and number of years in present position.		
2. How and with what frequency are financial statements submitted to:		
a. Operating management?		
b. Board of directors?		
c. Audit committee?		
C. Operating Analyses		
1. In multi-line insurance organizations, describe how reports on operating results and key financial data provided by major lines of business and/or subsidiary to the home office are		

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completed and how often.		
2. Describe the principal operating analyses used (e.g., line of business analyses, loss ratios, in-force and reserve amounts, investment yields). Describe contents, and indicate frequency of preparation. Sample analyses may be attached instead of a schedule.		
D. Investments		
1. Provide a copy of the company's investment policy and answer the following questions:*		
a. How often is the policy reviewed and updated?		
b. How is investment performance periodically reviewed by management?		
c. How are investment activities approved by the board of directors?		
2. Describe the policy regarding treatment of securities. Include whether securities are kept:		
a. On hand.		
b. With a nondiscretionary custodian.		
c. With a discretionary custodian. If kept with a discretionary custodian, advise if there is an approved list of investments.		
3. Describe the company's exposure to the following derivative risks:		
a. Those included on Schedule DB of the Annual Statement.		
b. Those not included on Schedule DB of the Annual Statement.		
E. Third-Party Administrators (TPAs)		
1. How are the services of TPAs used? Please provide a list of all TPAs used, and answer the following:		
a. Are detail records reconciled? If yes, how and with what frequency?		
b. Are internal audits performed? If yes, how and with what frequency?		

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F. Accounting Practices		
1. To what extent are internal controls formally documented?		
2. Are current-year statements prepared on the same basis (i.e., key accounting principles, actuarial and pricing assumptions) as used in prior years? Explain any differences.		
3. How does the company ensure that statements are prepared in accordance with state statutes and regulations?		
G. Reinsurance		
1. Do reinsurance agreements and material amendments require formal review and approval, prior to execution, by officers? Explain which officers complete this review and approval. Also note whether the board of directors also reviews and approves reinsurance agreements.		
2. Discuss any major changes in terms (e.g., commission, percent participation, limits or retentions) or conditions of contracts with significant management companies, agents or in reinsurance layers. Document in detail significant specific arrangements with agents, MGAs or others.*		
H. Assumed Reinsurance		
1. Are ceding companies required to submit appropriate periodic reports on the reinsured business? Indicate the extent and frequency of these reports.		
2. Are such periodic reports compared to projections made at the date of the agreement?		
a. If yes, how are material deviations investigated?		
3. To what extent does the company review or inspect ceding company records and changes therein (premiums, terminations, benefits or claims)?		
a. Are these reviews performed as of the assumption date?		
b. Are these reviews performed periodically after the assumption date? How often?		
I. Ceded Reinsurance		
1. Describe how the financial stability of assuming companies is reviewed to ascertain whether such companies are solvent and have the ability to meet liabilities assumed under the reinsurance agreement.		
2. Describe how the results of reinsurance agreements are monitored to permit timely recapture of ceded premium or		

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cancellation of assumed reinsurance.		
3. Who reviews and approves the decision to recapture or cancel the treaties?		
4. To what extent and how often does company management report on the reinsurance plan and communicate an evaluation of the plan's effectiveness to the board of directors?		
J. Liquidity The purpose of this section is to gather information on an insurer's stress liquidity exposures and financial flexibility for coping with both expected and unexpected cash demands. Reasonable groupings of like instruments should be used where specific asset and liability information is sought. However, there should be sufficient delineation to identify material differences. There should be no material omissions in responding to these questions. The analysis should be done for the general account and for guaranteed separate accounts (if applicable) unless otherwise specified. The requests for quantitative information refer to direct minus ceded plus assumed business in the aggregate. This section is intended for all insurers, with some questions specific to life companies only (#7-#9). In order to avoid duplication of efforts, the examiner should communicate with the financial analyst to determine whether this information has already been collected before requesting completion by the company.		
1. Does the company have a formal written liquidity plan?*		
a. If yes, provide an overview, particularly as it relates to coping with stress conditions.*		
b. If not, explain why a written liquidity plan is not necessary, and describe the company's liquidity policy, particularly as it relates to coping with stress conditions.		
c. What liquidity stress testing is performed? How often is such testing performed, and what are the most recent results?		
d. Describe how the company would respond to an immediate and material cash demand, such as one that would be triggered by a rating agency downgrade.		
e. Describe means of raising cash other than disinvestment, such as lines of credit and issuing commercial paper. What restrictions, covenants, etc., limit the company's ability to use these means? State the reasons why any such lines of credit are expected to be reliable, e.g., by describing the terms and conditions under which they		

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may be canceled by the lender.		
f. Describe any changes the company has implemented during the course of the most recent year to address stress liquidity (e.g., due to economic changes, changes in product mix or design, etc.).		
2. With respect to reinsurance agreements, ceded or assumed:		
a. Describe and quantify all reinsurance arrangements that have potential material impact on the company's liquidity exposure. A definition of materiality should be included in your response.		
b. Describe and quantify all reinsurance arrangements that include rating downgrade "put" provisions.		
3. Does the company hold assets or engage in investment activities that could result in liquidity risks that are not readily apparent through a review of financial reporting schedules? If so, please describe in detail, including the extent that such assets are relied upon to support demand liabilities.		
4. For the following questions, "large cash demand" is defined as equal to or greater than 10% of company surplus, and "institutional cash demand" is defined as cash value products of at least $10 million, under common control or ownership, for which the decision to access the cash is in a single person/entity.		
a. Can the total of the company's potential large and institutional cash demands, if any, have a material impact on the company's cash position? (Treasuries are considered cash for this purpose.) A definition of materiality should be included in your response.		
b. What impact can the potential capital losses from these demands have on the company's capital and surplus?		
5. Are any of the company's assets pledged or encumbered for purposes other than to directly support its insurance liabilities (e.g., FHLB loans, etc.)?*		
6. If yes, then please explain and also provide the amount of such assets.*		
a. To what extent would such assets impair the company's financial flexibility in a stress liquidity scenario?		
Describe all potential cash demands at the holding company level that can have a negative impact on the company's liquidity position.*		
7. Describe all general account guarantees associated with market value separate accounts of the company. (For this purpose,		

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"guarantees" means guarantees of principal, interest, performance indices, minimum benefits, or other arrangements where the company is liable for an amount greater than the market value of related separate account assets. Guarantees because of death or morbidity may be excluded.) What is the total liquidity exposure for each material guarantee as of 12/31/20XX? The value of any such guarantee is that amount, as of 12/31/20XX, deliverable to contract holders in excess of the market value of the separate accounts. A definition of materiality should be included in your response. *(Life Insurers Only)**		
8. Does the company have guaranteed investment contracts (GICs), funding agreements or similar instruments? *(Life Insurers Only)**		
a. If yes, list the 10 largest (in terms of withdrawals) holders of GICs, funding arrangements or similar instruments and their total withdrawal value (only those with contract holder cash-out options at either book value or market value). Liabilities associated with a given holder should be aggregated. For each of the holders listed, include the holder name, amount held, scheduled maturity, whether the contract holder can move funds at book value, and the terms/conditions under which funds can be moved.		
9. Does the company have corporate-owned life insurance (COLI) or bank-owned life insurance (BOLI) business? *(Life Insurers Only)**		
10. If yes, list the 10 largest (in terms of withdrawal value) holders of COLI and BOLI and their total withdrawal value. Liabilities with a given holder should be aggregated.		
V. LEGAL AND REGULATORY REQUIREMENTS		
1. Describe the procedures to ensure that management is informed of changes in laws.		
2. Are the following specific areas of company activities regularly reviewed for compliance with regulatory requirements? If yes, how often? Describe the documentation procedures and indicate who is responsible for:		
a. Capital requirements and dividend restrictions.		
b. Transactions with employees, directors and officers.		
c. Permitted ratios of categories of qualified investments to statutory capital and/or surplus.		
d. Prohibitions or restrictions as to particular kinds of investments.		

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e. Prescribed loan-to-value ratios for mortgage loans and similar credit-type investments. f. Policy form approval. g. Treatment of policyholders in benefit settlement matters. h. Disposal of real estate acquired by foreclosure. i. Permitted non-insurance activities. j. Foreign operations. k. Reporting. l. Others not already discussed above.		
3. Describe any government restrictions or regulatory requirements that pertain specifically to the company, including any permitted practices.		
4. Provide copies of any limited scope examinations and audits by regulatory or other government agencies. Discuss any IRS revenue agents' reports, deficiency assessments and developments in IRS examinations in progress.		
5. Has the company complied with all debt covenants and other agreements?		
6. Describe whether there are any material co[illegible]nt liabilities or commitments.		
VI. CODE OF CONDUCT		
1. Does the company have an established code of conduct? If so, provide a copy and advise what the code of conduct addresses and who receives it.*		
2. Does the company distribute the code of conduct and confirm that employees receive and understand the code and other policies? If so, please describe the process.		
3. Does the company have a process for updating policies and procedures? If so, please describe this process.		
4. Can any requirements established by the code of conduct and other policies be waived or overridden? If so, please describe this process.		
5. Under the code of conduct, can employees, agents and other stakeholders raise issues regarding compliance and ethics-related matters? If so, please describe this process.		
6. Does the code of conduct have an established procedure to address compliance and ethics issues that arise? If so, please describe this process and how the company scrutinizes the		

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source of compliance failures.		
7. Does the code of conduct provide guidance to take action against violators of the code? If so, please describe how consistently this has been applied or whether other provisions are in place to address this issue.		
8. Is there a process for determining which issues are escalated to the board and for informing the board when issues are resolved? If so, please describe this process.		
9. Are there ongoing processes in place to monitor the effectiveness of the compliance and ethics program? If so, please describe.		
10. Does the organization engage an external law firm or consultant to audit compliance and ethics program elements? If so, please list the firm or consultant.		
11. Is the company a member of the Compliance & Ethics Forum for Life Insurers and/or other best practices organizations? If so, please list.		

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Attachment 1 - Liquidity Tables

Table One – Cash Demands (in thousands) as of 12/31/XX

	Demand Class	0 to 7 Days	8 to 14 Days	15 to 30 Days	31 to 90 Days	91 to 180 Days	181 to 365 Days	Total
A	Large* of institution** demands							
A1	Statutory liability of (A)							
A2	Amount of (A) Deferrable for 6 Months							
A3	Reinsurance Receivable on Amounts in (A)							
B	Other Policy / Contract Cash Demands (including retail business)							
B1	Statutory liability of (B)							
B2	Amount of (B) Deferrable for 6 Months							
B3	Reinsurance Receivable on Amounts in (B)							
	Itemize Other Cash Demands							

Detailed Instructions

Maximum outflows should be provided net of any surrender charges or contractual rights that can defer, limit or restrict the outflows.

The liabilities included in the contractual cash outflows may include, but are not limited to, the following:

All Deferred Annuities, Annuities in Payout Phase, Maturing GICs, and Retail Notes based on payment schedule. Full Service cashouts, limited to 20% in a given year, Life, Disability, and Long-Term Care Claims based on payment schedule, Dividends to Clients for Claim Experience based on payment schedule, Cash Surrender Value for Variable, Universal, and Participating Life (Closed Block), net of any outstanding policyholder loans, Unscheduled large client withdrawals and group annuity participating minimum balance withdrawals, Stable Value participant withdrawals based on payment schedule, and Stable Value maturities and annuity payments based on payment schedule.

Footnotes to Table One:

Provide the maximum possible contractual cash demand on the Company (through surrender, loan or other contractual benefits) for transactions that have not occurred) for business in-force as of year-end. Other contractual benefits may include but are not limited to incurred claims, installment payments (e.g., disability benefits, payout annuities, etc.) and maturities.

Report demands from direct and reinsurance assumed business. Report reinsurance ceded offsets separately in A3 and B3. Report cash demands in the earliest period payable if the demand were made immediately (e.g., if $80 can be demanded now or $100 in 90 days, report the $80 in the 0 to 7 days column.)

Assume the company exercises any contractual rights with institutional customers to defer, limit, restrict or make payments in installments and report each amount in the appropriate period.

In lines A1 and B1, provide the amount by which the statement value of liabilities would be reduced as a result of meeting the entire cash demand shown in A and B. This value may differ from the cash demands due to surrender charges, withdrawal charges, market-value adjustments or statutory valuations in excess of account values. Use end of year market conditions where needed to determine the deduction in the statement value of liabilities, for example, to calculate a market value adjustment.

Exclude associated changes in AVR or IMR in lines A1 and B1.

In lines A, A1, B and B1, report demands before contractual deferral rights and report amounts deferrable for six months under Sections 4223(a)(1)(B) or 4221(a)(8) of New York Insurance Law separately in A2 and B2.

Itemized other demands would include, but are not limited to, investment commitments, off balance sheet risk, credit guarantees, support agreements for affiliates, demands related to securities lending, scheduled payments on FHLB funds, etc.

Include those amounts attributed to Retained Asset Accounts within Line B

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Attachment 1 - Liquidity Tables

Table Two: Cash Resources (in thousands) from general and guaranteed separate accounts as of 12/31/20XX

	Investment Category	Fair Value	Statement Value
A	Total Cash, Cash Equivalents and Short Term Investments (Page 2, Line 5)		
B	Investments maturing within one month from (C) through (K)		
	Publicly Traded		
C	US Gov't debt and agency obligations (not including structured securities)		
D	Corporate debt - Investment Grade (not including structured securities)		
E	Corporate debt - Below Investment Grade (not including structured securities)		
F	Structured Securities - Investment Grade (e.g., MBS, CMO, CDO)		
G	Non-affiliated Equity Investments		
H	All other publicly traded		
	Non - publicly Traded		
I	Corporate debt - Investment Grade		
J	Corporate debt - Below Investment Grade		
K	All other non-publicly traded (including commercial mortgages, structured Securities and Schedule BA investments)		
	Itemize other cash resources		

Footnotes to Table Two:

(A) should tie to General Account Asset Page 2, Line 5 plus Separate Account Guaranteed amounts for identical lines.

(B) includes scheduled sinking fund payments and coupon income.

Report each cash resource only once. Do not double-count. Items (C) through (K) should exclude what has been reported in (A).

Indicate the fair value and statement value for each cash resource at year end.

On-balance sheet cash resources should be included in Items (A) through (K), including on-balance sheet collateral held in connection to securities lending program. Other cash resources should exclude what has been reported in (A) through (K)

Other cash resources would include but are not limited to lines of credit, support agreements from affiliates, contractually required premiums and considerations, and collateral held off-balance sheet in connection to a securities lending program.

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EXHIBIT C
EVALUATION OF CONTROLS IN INFORMATION TECHNOLOGY (IT)

The evaluation of controls in information technology (IT) is a critical element of the examination process. Determining the complexity of a company's IT environment and the extent of work that must be performed to evaluate the controls in place is not always easy. Guidance on how to conduct an IT review is included within the General Information Technology Review guidance provided within Section 1, Part III of this Handbook. The tools included in this exhibit have been developed to assist the examiner in gaining an understanding of and evaluating the effectiveness of the company's general IT controls in mitigating common IT risks, as outlined within the General Information Technology Review guidance.

There are two main sections to this exhibit. Part One, the Information Technology Planning Questionnaire (ITPQ), is a tool designed to assist the examiner in planning the extent of IT control work that might be necessary on an examination. The ITPQ provides the insurance department with a high-level overview of the company's information technology environment. It is used to plan the scope and extent of IT control work to be performed and assist the examiner in determining which sections or risks included in the Evaluation of Controls in Information Technology (IT) Work Program (Part Two of this exhibit) should be prepared for the examination. To achieve maximum benefit, the ITPQ should be completed in advance of even normal examination planning, so that the examiner can begin planning what work the examiner will complete within Part Two.

Part Two of the exhibit is the Evaluation of Controls in Information Technology (IT) Work Program. The IT Work Program has been created to assist the examiner in identifying general IT risks, and to provide example controls and potential test procedures to assist the examiner in evaluating how well the company mitigates its general IT risks. Part Two of the exhibit replaces the Information Systems Questionnaire that has been included in previous editions of this Handbook, and should be used as the primary tool to evaluate a company's general IT controls. For more information on how the two parts of the exhibit should be used during the examination, please refer to narrative guidance included in the General Information Technology Review caption in Section 1, Part III of this Handbook.

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PART ONE – INFORMATION TECHNOLOGY PLANNING QUESTIONNAIRE (ITPQ)

For the questions below, provide the requested documentation and the name, title, telephone number and e-mail address of the individual who will be most able to discuss and clarify the information presented.

If a particular section does not apply to your company, give a brief explanation of why it does not apply. All responses should be in the form of a separate summary memorandum, headed with the corresponding section label. Where possible, electronic responses are preferred.

1. Use of Information Technology

If the company does not process its business electronically, provide a narrative description explaining how the company's business is processed. The remainder of this section does not need to be completed.

If the company only processes business electronically on a stand-alone personal computer and does not use networking technology, provide a narrative description explaining how business is processed, including the type of application software being used. The remainder of this section does not need to be completed.

2. Information Technology Governance

a. Provide the name, telephone number and e-mail address of the chief information officer (or equivalent).

b. Provide specific detailed organizational charts for the company's IT department, and/or any affiliates providing IT services, that show its various functional divisions (i.e., operations, programming, support services, etc.). Show reporting relationships of the IT department within the organization.

c. Provide an executive overview of your company's IT strategic plans, including plans for e-commerce.

d. Provide an executive overview of your IT steering committee, or other group that establishes and directs IT policies and strategies, indicating the membership of the group and the frequency of their meetings.

e. Provide an overview of ERM program, if not already provided, and associated touchpoints in relation to IT risks.

f. Describe the frequency, type, and content of interaction with the company's board of directors regarding key IT risks, such as cybersecurity.

3. Information Technology Infrastructure

a. Provide the name, telephone number and e-mail address of the chief technology officer (or equivalent).

b. Provide a listing of the locations of all data-processing centers used by your company, whether owned by the company or by a third-party administrator that processes data for the company.

c. Provide a system-wide map or topography, showing all hardware platforms and network connections, indicating all internal and external access points. In addition, complete a separate Systems Summary Grid for each platform (see Attachment 1). A sample Systems Summary Grid is provided with this questionnaire (see Attachment 2).

d. Provide a narrative explanation of the application-level interfaces (manual and automated) among the various programs/platforms (e.g., claims system feeds into the accounting system).

e. Provide a list of any business or data-processing services provided by the company to any other entities, including affiliates, indicating the type of service provided and a summary of the terms of the agreements (e.g., named parties, effective date, period and services covered). Also indicate if a service level agreement (SLA) exists for each of these services.

f. Provide a list of any business or data-processing services performed by any other entities on behalf of the company, such as a third-party administrator (TPA, MGA, GA, etc.) or an affiliate, indicating the type of service provided and a summary of the terms of the agreements (e.g., named parties, effective date, period, location and services covered). Also indicate if a SLA exists for each of these services.

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g. Describe any business the company is conducting through electronic channels, indicating the type and volume of business and the date when it was implemented. **Note:** E-commerce methods of transmission might include voice recognition units (VRUs), the Internet, third-party extranets, and wireless and broadband communications media.

4. Information Technology Audits, Reviews and Risk Assessments

a. Provide the name, telephone number and e-mail address for the partner of your company's independent external audit team and the internal audit director (or equivalent), if they exist.

b. Provide a list of any IT audits/reviews performed within the past two years, including e-commerce areas, cybersecurity assessments and any IT related reviews of financial significant 3rd party vendors. Include the dates, review subjects and who performed the audits/reviews (e.g., internal audit, external audit, SOC 1 Type II Reports, SOC for Cybersecurity reports, Sarbanes-Oxley, state insurance departments, governmental agencies, and/or any other contractor or affiliate that might have performed an audit/review).

c. Arrange for a copy of the IT work included in the most recent audit workpapers to be provided from the company's external audit firm. The workpapers should be provided no later than the response date identified for the IT Planning Questionnaire.

d. Please provide all current assessments of the company's IT risks, whether internally or externally conducted.

5. Information Technology Security

a. Provide the name, telephone number and e-mail address for the chief security officer (or equivalent).

b. Provide a copy of all IT security related policies.

If not explicitly described in the policies or if formal, written policies exists, please provide a detailed description of:

- Data Confidentiality – Discuss how data elements are classified and who determines which individuals/roles have access to data elements.
- Data Encryption – Discuss if confidential data is encrypted both at rest and in transit, including the process and methods of encryption.
- System and Network Access Controls – Discuss how access is controlled (network-level, server-level, application-level, or a combination), which directory services are used for network access, whether authentication servers are used, etc.
- Multi-Factor Authentication – Discuss the current use of multi-factor authentication including where it's used, the type being used, and any plans for expanding its' usage.
- Anti-virus/anti-malware – Discuss the anti-virus/anti-malware software, and patch management program in place including the systems used and the strategy for keeping these products current.
- Security Logging & Monitoring – Discuss the process and tools used for logging and monitoring security events across network devices, servers, endpoints, systems and applications. Also discuss how the company aggregates and correlates this information across the breadth of monitoring points.
- Intrusion Detection & Prevention – Discuss the program in place to detect and prevent intrusion into the company's network and systems including the types of tools and technology being used.

Vulnerability Management – Discuss the company's vulnerability management program including the scope of coverage, tools and techniques, frequency of scanning, reporting of known vulnerabilities, remediation, etc

- Penetration Testing – Discuss the types and frequency of penetration testing and whether it's conducted by internal employees or external firms. Also discuss whether the company uses advanced techniques such as red and blue team exercises.

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- Security Awareness Training – Discuss the security awareness training program required for all employees including how often it's required and how participation is tracked. Also discuss the contents of the training program and whether advanced techniques such as anti-phishing campaigns are conducted to reinforce the program.
- IT Asset Inventories – Discuss the inventory management program in place for physical devices, software and applications.
- Third–Party Vendor Management – Discuss the program to assess and address security risks posed by third-party service providers including the group(s) responsible risk ranking or tiering.
- Data Loss Prevention – Discuss the program in place to detect and prevent protected information from leaving the company

c. Provide a description of the types of sensitive information that is maintained or accessed by the company (e.g. Social Security numbers, protected health information, personally identifiable information, etc.) and the approximate amount of records containing each type of information. For each type of sensitive information, provide the number of outside vendors who have access to or maintain sensitive information.

d. If applicable, provide a description of updates to the company's controls and/or processes to ensure compliance with the General Data Protection Regulation (GDPR) or other applicable data protection requirements.

6. Information Technology (IT) Security – Incident Response

a. Provide documentation of the response plan in place for cybersecurity incidents. (Note that this may be covered by the disaster recovery plan, but the plan provided should include consideration of IT-specific events.)

b. Provide a listing of any instances in which confidential company or policyholder information was or was likely to have been breached. Include the following information in the response provided:

- How the event was detected.
- Correlation of events and evaluation of threat/incident.
- Resolution of threat, or creation and escalation of an appropriate work order.
- Post-remediation analysis, including any resulting change in controls/operations to mitigate threat of event reoccurrence.
- Extent of involvement of senior levels of management.
- Extent of expenses (including legal claims to be incurred) as a result of the incident.
- Details on the information that was compromised (both in quantity of information breached and type of information that was breached).

7. System Development/Change Management

a. Provide the name, telephone number and e-mail address for the system architect/chief software engineer (or equivalent).

b. Provide an executive overview of the company's system development life cycle (SDLC) and change-management methodologies and indicate whether the company uses internal personnel and/or external vendors to develop and/or change its systems or programs. Include discussion of the process used when purchasing application solutions.

c. Provide the name, vendor, version number and platform for all change management/system development software, if utilized.

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8. Business Continuity

a. Provide the name, telephone number and e-mail address of the individual responsible for maintaining, updating and testing the company's business continuity and disaster recovery plans.

b. Provide a copy of your IT business continuity and disaster recovery plans (if not already provided in response to the above questions), including information on any contracts for alternate sites (i.e., named parties, site location, type of site, effective date and period covered). Also, provide evidence of the last test results for the plans and management's resolutions of any test discrepancies.

c. Provide a description of your company's data and systems backup strategy, including your records retention policy.

d. Provide a copy of the most current business impact analysis.

9. Financially Significant Systems

a. If the company uses multiple platforms/systems to process financial transactions — including premium, claim, reinsurance and investment transactions — include a reconciliation of amounts processed on each separate system to total dollar amount processed during the prior year. Indicate whether the company anticipates any change in processing volumes during the current year. *Note: The Technology Summary tool provided on iSite+ or a comparable substitute that provides the same information should be used to accomplish this purpose.*

b. Identify and discuss other significant critical management reporting/operational systems, such as data warehouses, sales and marketing systems, communication systems, management dashboards and any other management information systems.

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Systems Summary Grid

For each primary hardware platform, list the application software products used in each of the insurance business cycles.

Hardware Platform (manufacturer/model)									
Operating System*									
Access Control Software**									
Program Management Software									
Database Management Software									
Hardware Location									
Business User Location(s)									
Individual Responsible									
Process/Application	Product Name and Version	Software Source: Developed Internally – Purchased – Not Modified – Purchased – Customized – Outsourced/Service Center	Developer/Vendor	Application Support: Internal/External (Provider Name)	Date of Initial Implementation	Date of Last Significant Update			
Policy Management (including premium-transaction processing and policy record management)									
Claim Management (including claim-transaction processing and record management, and reserving)									
Financial Reporting (general ledger and accounting)									
Investment and Fund Management (including investment-transaction processing and record management)									
Reinsurance Management									
Producer Management (including commissions-transaction processing and agent record management)									
Data Warehouse / Data Mart									

NOTE: Make as many copies as necessary to represent every primary hardware platform being used. These might include mainframe, minicomputer and/or network server systems. Additional financially significant applications should be inserted and tracked.

* e.g., z/OS, z/VM, Clearpath, OS/400, i5/OS, Windows Server 20XX, Open Enterprise Server, Linux, Unix, AIX, Open Solaris, etc.
**e.g., RACF, Top Secret, ACF2, BSafe, Active Directory, eDirectory, Solaris.

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Systems Summary Grid — Sample

For each primary hardware platform, list the application software products used in each of the insurance business cycles.

Hardware Platform (manufacturer/model)	IBM AS/400 Model 840					
Operating System	OS/400 v4r3					
Access Control Software	OS/400 and Client Access/400					
Program Management Software	Job Scheduler for AS/400					
Database Management Software	DB2 Universal Database for AS/400					
Hardware Location	Company's home office					
Business User Location(s)	Company's home office					
Individual Responsible	John Smith, VP - Underwriting					
Process/Application	Product Name and Version	Software Source: Developed Internally Purchased – Not modified Purchased – Customized Outsourced Service Center	Developer/Vendor	Application Support: Internal / External (Provider Name)	Date of Initial Implementation	Date of Last Significant Update
Policy Management (including premium-transaction processing and policy record management)	PMS v6r2	Developed internally	By company, using Cobol, C++	Internal	09/1987	10/1999
Claim Management (including claim-transaction processing and record management, and reserving)	Not on this platform					
Financial Reporting (general ledger and accounting)	Not on this platform					
Investment and Fund Management (including investment-transaction processing and record management)	Not on this platform					
Reinsurance Management	Not on this platform					
Producer Management (including commissions-transaction processing and agent record management)	PMS v6r2	Developed internally		Internal	09/1987	10/1999
Data Warehouse / Data Mart	Oracle Database	Developed internally		Internal	09/1987	10/1999

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EXHIBIT C
IT REVIEW STANDARD PLANNING MEMORANDUM

The following is an illustration of an IT Review Standard Planning Memorandum to assist examiners in documenting the results of the IT planning process. This illustration includes some basic elements that IT examiners may want to incorporate into the IT planning memo to adequately document the IT review plan.

Salutation

This section should be in any format the state deems appropriate for its purposes. At a minimum, all states that are placing reliance on the IT review should be included in the distribution of this memo.

Background and Scope

This section should identify the following: the companies under examination (domiciliary state and type may also be included as relevant), examination "as of" date and period under examination, and the examination team and/or contractors used.

Meetings with Critical Personnel

Examiner-In-Charge and Other Financial Examiners

This section should summarize the pre-examination meeting with the EIC and other examiners (e.g., examiners from other states participating in the financial examination). It should include the following: the date and time the meeting occurred, a summary of each topic discussed, operations considered significant to the company (e.g. Claims Handling, Premium Billing, etc. if known at this time), prior examination findings, and any other concerns noted.

Financial Analyst

This section should summarize the meeting with the financial analyst and include the following: the date and time the meeting occurred, a summary of each topic discussed, relevant items from the Insurer Profile Summary, and any concerns regarding the company's systems identified as a result of the financial analysis process.

Company Personnel

This section should summarize the preliminary meeting with company personnel and include the following: the date and time the meeting occurred, a description of who was in attendance (examiners and company representatives) and a summary of each topic discussed, including who provides the IT services to the insurer, what the size of the IT operations are, where IT personnel are located, whether any recent changes have been made to the IT control environment, whether any key operations or functions are outsourced, and who the key company contacts are for the IT review.

Review Documentation and Issues Identified

Work of Others

This section should identify work performed (including any issues identified) by outside parties who have reviewed the IT function. This section should also identify and provide a preliminary assessment on how the work of others will be relied upon. Examples of the work of others that may be utilized include work done by other states, external CPAs, the company's internal audit or risk management function and third-party consultants used by the company. This work could include, but is not limited to, Sarbanes-Oxley 404 or Model Audit Rule workpapers.

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ITPQ

This section should summarize results of the ITPQ and include a reference to the completed document.

At the conclusion of this section, the IT examiner should document any issues identified during the meetings or from reviewing the sources listed above that will be considered while conducting the IT review. They should also develop a preliminary assessment of the general control environment identified in the examination process.

Budget

Detailed Time Estimate, Staffing and Schedule

This section should include an estimated time budget, staff resources to be used, and a schedule of when the IT work will be performed. This section would also include timelines for deliverables and a representative draft of the work program expected to be performed.

Note: The IT examination budget should include an initial estimate of time, which is subject to change based upon the availability of information, the extent of testing necessary and any other relevant factors.

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PART TWO – EVALUATION OF CONTROLS IN INFORMATION TECHNOLOGY (IT) WORK PROGRAM

This work program has been created to assist examiners in completing a review of the general controls of a company's information technology (IT) in accordance with the risk-focused examination process. Detail instructions for completing this program can be found in Section 1, Part III, under "General Information Technology Review." Due to the inherently high degree of change in IT information technology, the period under review for this work program should generally range from the latest 12 to 24 months of the overall financial condition examination time period. The period under review should generally encompass the last year of the examination period and the period of time up to, and including, the actual examination fieldwork.

This work program assists the examiner in identifying the most common risks that are often inherent within the general IT controls of a typical insurance company. Included with the risk statements are examples of common controls, information requests and test procedures that may assist the examiner in determining how the company mitigates each risk.

This work program is categorized into four sections: Align, Plan and Organize (APO); Build, Acquire and Implement (BAI); Deliver, Service and Support (DSS); and Monitor, Evaluate and Assess (MEA). These sections are modeled after the COBIT Framework, due to its wide acceptance and use in the IT community. Although these sections are modeled after the COBIT Framework, they do not incorporate all of the control objectives of COBIT; rather, they incorporate only the most common control objectives that might need to be reviewed in an insurance company examination. APO addresses strategies and tactics and integrates IT into the overall business needs and objectives of the company. BAI addresses the identification, acquisition and implementation of the IT strategies and tactics identified within the APO section. DSS addresses the actual delivery of IT services identified in the BAI section. MEA assesses whether the IT processes from all sections are functioning adequately. The COBIT 5 Framework includes a fifth domain, Evaluate, Direct and Monitor (EDM) that assesses the overall governance of the IT environment. This domain was not incorporated in Exhibit C, Part 2 as the concepts presented throughout this domain are considered in other areas of the exam including the review of corporate governance.

In certain situations, additional language has been added drawing on content within other IT frameworks (e.g., the National Institute of Standards and Technology [NIST], etc.) or drawing on content provided by state insurance regulators.

This work program is meant to be customized to include only the general IT risks that are of concern for the company under examination. As a result, the work program will vary from company to company, as the content will depend on the size and complexity of each company's IT environment. After the risks of concern have been identified, the examiner should consider making common control examples and information requests available to the company to assist the company in explaining how it mitigates each risk. A separate work program template, intended to be sent to the company, is maintained on StateNet and includes a column for "Company Controls Identified," where the company will be able to document their specific controls for the risks identified by the examiner. This template is designed to assist the examiner in identifying the risk statements, common controls and test procedures, based on the knowledge gained from the examiner's review of the company's response within the Information Technology Planning Questionnaire (ITPQ) and other information gathered as part of the "General Information Technology Review" guidance within Section 1, Part III (A). The IT review team should coordinate with the appropriate staff at the company to request this response. After the response is received, the examiner should perform testing as necessary to corroborate the company's risk-mitigation strategies.

Third-Party Work

To assist in the identification and review of unique risks, examiners should obtain all available reports generated as a result of third-party work to ensure that the examiner has access to relevant findings from other entities. Examiners should understand work performed by other entities in auditing/reviewing the insurer's IT systems (e.g. independent third-parties, federal regulators, etc.) and consider whether the work performed by other entities contains sufficient testing such that reliance can be placed on their work and whether the findings have been suitably addressed, as appropriate.

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The following insights may assist regulators and/or cybersecurity experts as they review work performed by third-parties to assess company information security programs. These insights are intended for informational purposes and do not indicate expectations or requirements for insurers. However, if companies have contracted with third-parties to have such work performed, examiners are encouraged to obtain, review, and leverage the work to create efficiencies within the exam process. Among the more common reports issued by independent third-parties that regulators may consider leveraging are:

HITRUST Reports

Health Information Trust Alliance Common Security Framework (HITRUST CSF) Assurance Program validated reports have become increasingly common due to the rise in cybersecurity exposures. HITRUST CSF was developed to provide healthcare organizations a standard reporting framework which covers a multitude of security frameworks, including COBIT and NIST. Paired with the CSF Assurance Program, these standardized reports may be useful to regulators when evaluating both the insurer's IT General Controls as well as the insurer's cybersecurity exposure. In reviewing these reports, regulators should determine whether the report is a CSF Validated Report or a CSF Validated Report with Certification. The Certification is awarded in situations where the organization completes a validated assessment and meets a certain scoring threshold (i.e. rating of 3+ on each of the control domains) as well as meets other specified criteria. Certifications are valid for two years from the certification date on the condition that interim reviews and certain monitoring requirements are met. Each report should contain a "Scope of Systems In the Assessment" (Section 5 of the report) that will allow regulators to quickly determine the specific organizations and systems that were considered within the report. CSF Reports are required to be performed by one of 30+ authorized assessors. The HITRUST limit on entities that can issue CSF Reports may be leveraged by regulators to provide comfort over the qualifications of the professionals performing the work. In situations where an insurer has prepared a CSF Self-Assessment, that work may be leveraged as noted in the Section 2, Phase 1 (C) "Utilization of Company Performed Testing" guidance whereas a CSF Validated Report (with or without Certification) may be leveraged under the subsection "Decision Whether to Utilize the Work of Auditors".

SOC II Reports

Although all System and Organization Controls Reports may be useful, SOC 2, Type II Reports may provide regulators with the most comfort over an insurer's IT General Controls and or cybersecurity exposure. The type of testing performed in a SOC 2 engagement is driven by the Trust Principles on which an opinion is being provided. As regulators review these reports, they may find SOC 2 reports with the Security, Confidentiality or Privacy Trust Principles selected as having the most relevance for a regulator performing an IT Review within a financial exam. Regulators may also consider the information provided in the "System Overview and Background" section of the SOC 2 report as this will indicate whether the scope of the SOC 2 report is sufficient to allow the regulator to leverage the work performed. The complimentary user entity controls helps ensure that the controls at the insurer are in line with and complement the controls at the third party service provider. For example, if the insurer outsources various services, the third party service provider may have good controls around user onboarding and termination (i.e. terminated user accounts are disabled within 24 hours), but the insurer may not have a control that would notify the service provider timely when a user is terminated. Because of the control weakness at the insurer, the service provider's control is not effective despite its good design and effectiveness as assessed by the SOC auditor.

Note that it is possible for a firm to issue a SOC II leveraging the HITRUST CSF controls, but this is not strictly equivalent to having a Validated Report, as referenced in the HITRUST section above. While both reports may provide value, any SOC II Report may have differing value as a HITRUST Report is generally more comprehensive.

SOC for Cybersecurity

SOC for cybersecurity reports were created in 2017 with the aim of establishing a standardized framework for evaluating the effectiveness of an entity's cyber-risk management controls. These reports are similar to SOC II

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reports, with several important differences. First, SOC for cybersecurity reports are designed for a more general audience, meaning that a person without intricate knowledge of a company's IT systems would still be able to glean useful information from this report. Therefore, SOC for cybersecurity reports will not contain details and specific results of testing procedures performed by certified public accountants (CPAs). (Such information is normally available within an SOC II report.) Rather, SOC for cybersecurity reports present information in a context aimed at helping the user understand operating effectiveness of an organization's cybersecurity controls. Another distinction is that SOC for cybersecurity reports are more customizable that SOC II reports. Management can choose the criteria for SOC for cybersecurity reports so long as the criteria chosen are suitable under the clarified attestation standards. Examiners should take special consideration of the scope of SOC for cybersecurity reports when utilizing information for an examination. SOC for cybersecurity reports are advantageous for determining organizational vulnerabilities from cyber threats, whereas SOC II reports would give an examiner a better understanding of the organization's IT General Controls.

PCI Compliance Reports

Payment Card Industry (PCI) Data Security Standards (DSS) are designed to help ensure cardholder data is protected. Although generally focused on the security of system components that are located within or connected to the cardholder data environment, depending on the information included in the report provided, regulators may be able to leverage the reports to assist in addressing an insurer's cybersecurity exposure. Therefore, as these reports are obtained and reviewed, regulators should first consider the scope of the systems reviewed and compare that against the insurer's broader operating environment. If the scope of the systems reviewed is significantly narrower than the insurer's IT infrastructure, the value of the report is somewhat limited. However, the report obtained may still be able to provide insights for specific systems within the IT infrastructure, depending on the risks identified within the IT review work program.

Other Third-Party Work, Including Penetration Tests, Cybersecurity Program Assessments and Vulnerability Assessments

Insurance companies have been contracting with third parties to review, assess, or scan the insurer's security program and identify recommendations for enhancements. Penetration tests typically analyze the security infrastructure and environment of the insurer. During the test, security risks, vulnerabilities, and physical and logical attack vectors are identified. The results of the test will evaluate the current state of the network and benchmark the network against other similar companies. Often times, the third-party will offer remediation recommendations if vulnerabilities are found. Cybersecurity program assessments typically apply a cybersecurity framework to establish scope and baseline. The insurer's security policies and practices are then evaluated against the framework. Vulnerability assessments are a process to define, identify and classify the security gaps in the network, communications infrastructure, or applications. Companies also obtain Cyber Risk Analytic reports to provide an overall score and assessment on specific aspects of a company's information security program. Cyber Risk Analytics may also be used by companies as a control in the vendor management process. Third-party work may also be leveraged by regulators to provide more meaningful insight on the insurance company's information security program. In situations where the reports obtained were provided by a division of the company (e.g., internal audit, etc.), regulators may be able to leverage the work, but may need to exercise increased professional skepticism as compared to work where the work is performed by an independent expert.

Regardless of the report being reviewed, regulators should specifically consider the scope of work, independence of the firm performing the work, qualifications of the vendor performing the work, timing of the work performed, and the findings included in any report received. Based on the regulator's review of the third-party work, regulators may be able to use the work to enhance the risk assessment, interview, and scoping process performed during the IT review. To the extent that findings are noted in the report obtained, regulators may find it more useful to corroborate the remediation of the findings as opposed to performing an independent review of the company's controls to confirm the finding's existence.

Regulators should also consider the sensitivity of the information contained in these reports, as they request access to and document their review of the reports. Regulators should consider whether an on-site, "read only" review is appropriate,

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especially in situations whether the reports make specific references to identified vulnerabilities. Regulators may also wish to only document a general summary of their review as opposed to making more specific notations of their review based on the sensitivity of the information contained in the reports reviewed.

Note that in situations where management has contracted with third-parties to perform cybersecurity assessments, IT examiners can leverage the procedures performed based on the examiner's judgment. In determining the degree of reliance, the IT examiner should consider the factors noted in Handbook Section 1, Part III (F) under the subsection "SSAE 18 and Service Organization Control Reports" and Section 2, Phase 1 (C) under the subsections "Decision Whether to Utilize the Work of Auditors" and "Utilization of Company-performed Testing."

Small/Medium-Sized Company Guidance

For many small or medium-sized insurers, a number of the risks and suggested test procedures included within this work program may not be relevant. As such, the risks identified and testing to be performed should be customized to meet the needs of each individual examination. However, the work performed should allow the examination team to determine whether general reliance can be placed on a company's IT general controls. To ensure that sufficient work is performed, the customized program should continue to address each of the four primary COBIT domains, at least at a basic level. Examiners may find it useful to reference COBIT QuickStart guidance available to assist in customizing the work program for a smaller insurer. In addition, other instructions for completing an IT review for small/medium-sized companies can be found in Section 1, Part III, under "General Information Technology Review."

Additional explanations for the information included in this document and how it may be used by the examiner are as follows.

Risk Statement

The risk statements provided within the work program are the most common general IT control risks an examiner will likely encounter at an insurance company. This is not designed to be an all-inclusive list of common risks at a company. The information gathered from the ITPQ and other relevant sources should assist the examiner in identifying other risk statements that apply to the company.

Common Controls

The common controls provided within the work program indicate how a typical insurance company might mitigate the specific risks shown in the "Risk Statement" column, but may not apply to each individual company. Each company has its own controls in place to mitigate the identified risks, which may or may not correspond to the common control identified within the work program. Therefore, the company might have adequate controls in place, even if the control does not match the common control listed in the work program. The examiner may wish to provide the common controls to the company under examination to assist the company in developing responses, including controls used to mitigate the identified risk statements.

Preliminary Information Request

The information requests provided within the work program are the minimum level of documentation the examiner will likely need to obtain in order to support the common controls identified within the work program. This list is not designed to be all-inclusive and will not necessarily provide the detailed information necessary to perform all of the possible test procedures listed in the next column. The examiner should also consider that each company has its own form of documentation, which might differ from the information request listed in this work program. The examiner may wish to provide the information request, along with the risk statements and common controls, to provide an understanding of the evidence expected to be provided by the company under examination. In some instances, the examiner will need to request additional detailed information to perform the possible test procedures included in the work program.

Possible Test Procedures

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After gaining an understanding of the controls in place to mitigate the relevant risks, the examiner should test the effectiveness of the company's controls. Examples of possible test procedures are included in this work program. The test procedures provided are not designed to be an all-inclusive list and might not apply to all insurance companies that are under examination. In some circumstances, the examiner will need to develop additional test procedures or modify existing procedures beyond what is included within the work program. As mentioned above, for some possible test procedures, the examiner will need to request additional detailed information to perform testing. In addition, it is not expected that all possible test procedures will be utilized for all companies under examination.

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INSTRUCTION NOTE 1: After the examiner has identified controls over the company's IT environment, based on the company's responses to the ITPQ and other information provided to the examiner, the examiner may determine that these controls over the company's IT environment should be tested for operating effectiveness. Section 1, Part III of this Handbook provides specific guidance on sampling for tests of controls and should be utilized by the examiner when testing the company's identified controls. In some cases, the examiner may be asked to assist in the financial examination, as outlined in the "General Information Technology Review" in Section 1, Part III of this Handbook. If it is determined that some of this work includes substantive testing, the examiner should utilize the substantive sampling guidance provided in Section 1, Part III of this Handbook.

INSTRUCTION NOTE 2: The following issues are addressed in Part One (ITPQ) and Part Two (Evaluation of Controls in IT Work Program). If the ITPQ is utilized and subsequently it is determined that all sections and risks included in the IT work program should be addressed, the responses received in the ITPQ should be considered when requesting information on the corresponding sections of the IT work program listed below.

Information Technology Planning Questionnaire (ITPQ)	Evaluation of Controls in Information Technology (IT) Work Program
2b	APO 01.02, APO 01.02, MEA 02
2c	APO 02
2d	APO 02, APO 04
3e	APO 09
3f	APO 10
4a – 4d	MEA 02
5b	DSS 05.01 – 05.04
7a	APO 03
7b	DSS 03.05, BAI 02.04, BAI 03.05, BAI 06
8b – 8d	BAI 03.02, BAI 04.02, DSS 04

INSTRUCTION NOTE 3: Examiners may determine that cybersecurity risks are significant for the insurer under examination. This may be based on responses provided to the ITPQ, results of planning and examiner's judgment. To ensure that the examination procedures performed include an adequate response to the insurer's cybersecurity risk, which can affect multiple facets of the IT environment, examiners may consider performing procedures in relation to risk statements APO 1, APO 10, APO 12, DSS 02 and DSS 05. Note these risk statements and associated procedures may or may not explicitly mention the threat of cybersecurity in the language presented, but examiners should customize the procedures provided to respond to this risk as appropriate. Examiners may determine that additional risks are relevant when considering cybersecurity exposure and should tailor their work program based on information available on the exam. Additional considerations for cybersecurity concerns are located in Section 1-III (A) of the Examination Handbook guidance, entitled "General Information Technology Review."

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PART TWO – EVALUATION OF CONTROLS IN INFORMATION TECHNOLOGY (IT)
WORK PROGRAM – ALIGN, PLAN AND ORGANIZE (APO)

Risk Stmt #	Risk Statement	Ctrl #	Common Controls	Preliminary Information Request	Possible Test Procedures
APO 01	IT organizational structure is inadequate to support business objectives.	APO 01.01 – APO 01.02	The company's IT management organizational structure, with clearly defined roles and responsibilities, supports business objectives and IT priorities and ensures efficient decision making.	Provide the IT organization chart showing job title and names of IT executives and managers and reporting lines to CEO and the BOD. Provide resume/biographical information from key IT executives. Provide list of IT governance committees (e.g., IT strategy steering committees, etc.)	Review and assess adequacy of IT governance model. Consider segregation of duties and clearly defined roles and responsibilities. Review IT governance committees to determine whether business is adequately represented to facilitate IT priorities in supporting business objectives.
		APO 01.03-APO 01.04	The company has established and communicated IT standards to ensure consistency and to drive compliance across the organization.	Provide IT policies and procedures, including security, HR policies and IT training programs documentation.	Assess policies and procedures to ensure currency and completeness. Determine whether IT security is embedded in HR policies for all employees. Review training programs and schedules to confirm the management and employees are provided with sufficient training to understand the importance of compliance with IT and cybersecurity policies, including awareness of concepts of phishing, malware and data loss prevention, as appropriate.

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Risk Stmt #	Risk Statement	Ctrl #	Common Controls	Preliminary Information Request	Possible Test Procedures
					Assess the level of security awareness throughout the organization, including the awareness of the board of directors and senior management, as appropriate to their distinct roles.
APO 02	Enterprise business objectives cannot be attained due to the development of an IT strategy that is inadequate, ineffective and not in alignment with business objectives, including inadequate management oversight over the achievement of the IT strategy.	APO 02.01 – APO 02.05	The IT strategic planning processes considers the current enterprise environment and business processes, as well as the enterprise strategy and future objectives. Additionally, consideration is given to the external environment of the enterprise (e.g., industry drivers, relevant regulations, basis for competition).	Provide copies of IT strategic plans and evidence of strategic planning meetings, including membership, attendance, agendas and minutes.	Verify that strategic plans are developed by an IT steering committee (or its equivalent) with adequate input and involvement of IT management and key executive personnel from all significant business units. Interview senior IT personnel and review the IT strategic plan development process to understand how the IT strategic plan is developed and updated in alignment with the business. Interview IT steering committee members to verify the following: 1) The strategic IT plan is consistent with business objectives. 2) Contributing committee members are aware of corporate short-term and long-term goals. 3) The IT strategic plan is based on a current understanding of systems, including input from stakeholders. 4) Risk and resource implications of the required IT capabilities were considered.
APO 03	Enterprise goals may not be met because the data and systems architecture is	APO 03.01 – APO 03.03, APO 03.05	The company has an information architecture model that addresses the creation, use and sharing of data between	Provide documentation to support the company's information architecture model and the associated standards.	Review the information architecture model and verify that the model considers all significant business processes, including user-developed applications such as Lotus Notes and Access databases.

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Risk Stmt #	Risk Statement	Ctrl #	Common Controls	Preliminary Information Request	Possible Test Procedures
	poorly aligned and/or fragmented		applications that maintain data integrity, flexibility, functionality, cost-effectiveness, timeliness, security and availability.		Compare the information architecture model to the system summary grid to verify that all significant areas are addressed. Review the information architecture model to verify that the company has created standards that address data integrity, flexibility, functionality, timeliness, cost-effectiveness, availability, and security between applications.
				Provide a copy of the membership, agendas, and minutes of the meetings of the information architecture board.	Review membership, agendas and minutes of the Information Architecture Board to verify that they are involved in the oversight of technology.
APO 04	Company operations may lack efficiency and competitive advantage because system technology is obsolete and poorly aligned with business objectives.	APO 04.02	The company has an IT steering committee (or equivalent) that provides direction and input to IT for system and application solutions.	Provide a copy of the membership, agendas, and minutes of the meetings of the IT steering committee.	Review membership, agendas and minutes of the IT steering committee to verify that they are exercising the appropriate oversight of IT, including prioritization of IT investments and consideration of innovation.
		APO 04.04 – APO 04.05	The company has a technology advisory board (or equivalent) that identifies emerging technologies and/or other IT innovations.	Provide a copy of the membership, agendas, and minutes of the meetings of the technology advisory board.	Review membership, agendas and minutes of the technology advisory board to verify that they are providing information on emerging technologies and other IT innovations, as well as evaluating and monitoring the results of proof of concept initiatives.
APO 06	The IT budget is not representative of the organization's goals and business needs,	APO 06.01 - APO 06.05	The IT budget is developed based on strategic plan initiatives.	Provide evidence that the IT budget is based on supporting the strategic plan.	Review budget documentation to verify consistency with the strategic plan. Interview senior IT management to verify that the IT budget is created based on the IT strategic plan.

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Risk Stmt #	Risk Statement	Ctrl #	Common Controls	Preliminary Information Request	Possible Test Procedures
	and IT expenses are not properly allocated.				Determine if a chargeback system exists and verify that the IT costs appropriately transfer to business units for IT services rendered.
			The company has a formal budget monitoring process to identify and address budget variations.	Provide evidence of the budget monitoring process.	Review company documentation to verify that the company is adequately monitoring IT costs, service levels, and service improvements.
				Provide a copy of the budget variance report, or similar document.	Review the company's budget and variance explanations for reasonableness. Identify whether the variances were the result of control deficiencies that need to be addressed.
APO 09	IT-enabled services and internal service levels are not managed to ensure that IT services align with enterprise needs and expectations.	APO 09.01-APO 09.05	The company has a defined framework that provides a formalized service level management process between the customer and service provider. The framework should: 1) Provide for the creation internal service level agreements (SLAs) that formalize IT services provided, including performance measures. 2) Provide for continuous alignment with business requirements. 3) Include processes and procedures such as monitoring of	Provide a copy of policies and procedures relating to support provided for IT services.	Verify that the performance standards are being achieved. For performance standards that are not met, ensure that there is a proper resolution process.
				Provide a listing of internal SLAs supporting IT services provided to business customers.	Select a sample of SLAs from the listing obtained. Inspect and verify SLA policies and procedures to ensure that agreements: 1) Are approved by responsible company personnel. 2) Contain measurable performance standards. 3) Align SLA objectives and performance measures within business objectives and IT strategy.
					Ensure that SLAs are reviewed and revised when needed.

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Risk Stmt #	Risk Statement	Ctrl #	Common Controls	Preliminary Information Request	Possible Test Procedures
			availability, reliability, performance, capacity for growth, levels of support, continuity planning, security and demand restraints. 4) Ensure that regular reviews of SLAs and supporting contracts are performed to ensure that formalized IT services are being provided.		
APO 10	Third-party service provider risks are not properly assessed, addressed, and mitigated.	APO 10.01 - APO 10.05	The company has a formal process in place to manage service providers. The company creates formal agreements with the service provider to identify roles and responsibilities, expected deliverables, performance standards and credentials. Contracts conform to business standards in accordance with legal and regulatory requirements. Nondisclosure agreements, escrow accounts and	Provide a copy of the company's vendor-management policies and/or procedures. Provide a list of third-party service providers (suppliers), including the type of services provided, their significance and criticality.	Inspect a sample of third-party provider contracts (agreements), including those who are considered significant to the company, SLAs and other documentation to ensure that the contracts: 1) are current; 2) have been properly approved and correspond with the company's policies and procedures; and 3) conform to business, legal and regulatory requirements. Through review of company policies and procedures, along with interviews of staff, verify that the company adequately addresses ownership or relationship management responsibilities for ensuring that the outside service provider continues to be viable, and that contracts are maintained, monitored and renegotiated as required to continuously meet business requirements.

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			conformance with security requirements are included as considered necessary.		
			Reviews are performed on outside service providers during the contracting process to evaluate the appropriateness and effectiveness of their control environment.	Provide details of vendor risk reviews performed during the vendor selection or contracting process.	Review available reports to help verify that the company reviews the effectiveness of service provider controls. Consider the impact of any exceptions identified.
			The company has a formal process in place whereby: 1) Risk is assessed based on the company's understanding of the third-party service providers information security program as well as by the company's ability to verify elements of the third-party service provider's security program; 2) Based on the company's risk, the company ranks vendors and uses a vendors ranking to determine depth and frequency of review procedures performed related to	Provide a summary of the company's third-party service provider management process.	Review the company's third-party service provider management process including consideration of: 1) Whether the listing of third-party service providers is comprehensive and complete; 2) Whether the company has appropriately determined access rights based on its risk assessment; and 3) Whether the company has designed appropriate controls that are consistent with the company's risk assessment.

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			ongoing vendor relationships; 3) The company determines appropriate access rights, based on the risk assessment and company needs; 4) The company designs specific mitigation strategies including network monitoring specific to third-party service providers and access controls where appropriate.		
APO 12	IT-related enterprise risks have not been integrated into the overall enterprise risk management (ERM) program.	APO 12.02 – APO 12.05	The company maintains a documented and functioning ERM program that identifies IT-related enterprise risks.	Obtain copies of the ERM program.	Review the ERM program to determine IT integration. Interview IT senior management to verify that an IT risk and control framework has been adopted throughout the organization and to verify that appropriate reports relating to adoption of the framework have been provided to the board of directors or a committee of the board as appropriate.
			An IT risk profile is actively maintained describing known risks and risk attributes and of related resources, capabilities and current control activites.	Provide the company's risk profiles. Obtain a copy of the most recent risk assessment.	Review risk profile and assessments for timely and relevant information on the organization's most significant IT risks and subsequent mitigating controls.
			Continual communication on	Obtain risk analysis and risk profile reports	Review evidence that the company is providing risk analysis information to stakeholders to

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			current state of IT-related exposures and opportunities.	provided to all stakeholders.	communicate the current state of significant IT risks and the adequacy of risk response. Assess management awareness of risk analysis and risk profile reports and, if applicable, review and/or verify initiatives as a result of IT-related exposures and opportunities.

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PART TWO – EVALUATION OF CONTROLS IN INFORMATION TECHNOLOGY (IT) WORK PROGRAM – BUILD, ACQUIRE AND IMPLEMENT (BAI)

Risk Stmt #	Risk Statement	Ctrl #	Common Controls	Preliminary Information Request	Possible Test Procedures
BAI 01	IT projects may fail to meet business objectives/ERM goals or run over budget in the absence of an effective program and project-management methodology.	BAI 01.01–BAI 01.05, BAI 01.07 BAI 01.12, BAI 01.14	A methodology exists to maintain the portfolio of projects that includes identifying, defining, evaluating, prioritizing, selecting, initiating, managing and controlling projects	Provide a copy of the existing IT project-management and System Development Life Cycle (SDLC) methodologies.	Review the project life cycle and SDLC methodologies and verify that it addresses the key aspects of projects, including responsibilities, project plans, project resources, timeliness, deliverables, approval requirements, benchmarking based on key indicators (including risk management and project quality plans) and post-implementation reviews. Review a sample existing project to verify adherence to the project-management standards and methodology.
BAI 02	Projects are initiated without proper authorization and/or analysis.	BAI 02.01–BAI 02.03	The company has a defined process to identify and approve automated solutions, which include business functional and technical requirements, risk analysis reports and feasibility studies.	Provide evidence that business functional and technical requirements, risk analysis reports and feasibility studies were appropriately considered in the project approval process.	Evaluate the documentation received from the company for existence, approval, timeliness and appropriateness.
				Provide evidence of the procurement policies and procedures.	Review the company's IT procurement policies and procedures to verify that management approval, cost justification, business suitability needs, legal review of contractual issues and viability of the vendor are addressed.
				Provide a listing of recently completed projects that have been created or acquired within the past 18 months.	Select a significant project(s) to verify that documentation supports the process defined by the company. Gain an understanding of the process and verify

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					whether it appears reasonable. Verify that the company's process requires cost/benefit analyses be adequately reviewed by project stakeholders and senior management. For a selected significant development project(s), verify the completeness, timeliness and reasonableness of the cost justification and related project approval.
		BAI 02.04	Senior management and other stakeholders approve project plans before work commences on each significant phase of the development process used for all automated solutions.	Provide evidence of management approval for project plans.	From the project(s) selected above, verify that senior management and other stakeholders approved work prior to commencement of each significant phase of the development process.
BAI 03	Project deliverables fail to meet business objectives due to inadequate design and/or ineffective oversight of implementation.	BAI 03.01	Design specifications translate proposed solutions into business processes, supporting services, applications, infrastructure and information repositories capable of meeting business and enterprise architecture requirements. Quality assurance, project stakeholders and the sponsor/business process owner approve final designs, based on	For significant programs and projects selected by the examiner, provide copies of design specifications.	Review the significant programs and projects selected by the examiner and determine whether the design specifications are approved by management and whether business and enterprise architecture requirements are addressed. Review the quality assurance support for appropriate approval, based on agreed-upon criteria. Verify that the system design includes specifications of transaction types and business processing rules, automated controls, data definitions/business objects, use cases, external interfaces, design constraints and other

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			agreed-on criteria.		requirements. Verify that the tools used to monitor costs are effective and properly used. Verify that the cost-monitoring process is adequately comparing actual hours and expenses to budgeted amounts.
		BAI 03.02	Programs and projects are designed to address system redundancy, recovery and backup and provide for the ability to audit transactions and identify root causes of processing errors.	Provide documentation to evidence the existence of adequate business continuity, recovery and backup plans.	Determine if the company has adequate business continuity, recovery and backup plans. Select a sample of significant programs and projects and verify that the ability to audit transactions and identify the root cause of processing errors exists.
		BAI 03.05	Business and IT solution components and information repositories are integrated and configured in line with detailed specifications and quality requirements. The role of users, business stakeholders and process owners are considered in the configuration of business processes. Audit trails are implemented during configuration and	Provide listings of automated controls that provide for accurate, complete, timely, authorized and auditable processing. Provide the company's data classification, information architecture, information security architecture and risk tolerance guidelines. Provide the company's development procedures and standards guidelines that address items such as procurement process and	Determine if programs and system are configured to allow for accurate, complete, timely, authorized and auditable processing. Review the company's data classification, information architecture, information security architecture and risk tolerance guidelines. Assess if system configuration provides for adequate integrity. Validate that IT procurement procedures address the services needed by the business.

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			integration of hardware and infrastructural software to protect resources and ensure availability and integrity. Acquired application software is configured to meet business process requirements.	acquisition strategy, hardware, software and services, etc.	
		BAI 03.06	The company has a quality assurance (QA) process to review the software to ensure that business requirements are met.	For a sample of significant programs and projects selected by the examiner, provide evidence and documentation of the QA function.	Review the software QA practices relative to program and system development to ensure related processes align with the organization's QA practices. Review documentation of the software QA process for appropriateness. Review the detail QA testing for adherence with company standards.
		BAI 03.07–BAI 03.08	Integrated test plans and practices are commensurate with the enterprise environment and strategic technology plans. The company has established a test environment that is representative of the production environment and takes into consideration security,	Provide evidence that would support the use of integrated testing and strategic technology plans. Provide a copy of the company's policies and procedures surrounding the usage of the test environment.	Validate that integration test plans and practices enable the creation of suitable testing and simulation environments. Validate that the test environment adequately supports the application requirements and mirrors real-world conditions, including the business processes and procedures, range of users, transaction types and deployment conditions. Review completed test work to determine if test plans were followed and in accordance with standards.

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			workloads and data quality.		
		BAI 03.08	The company performs testing in accordance with its defined plan, prior to migration to the production environment. Testing outcomes are recorded and the results communicated to stakeholders in accordance with the test plan.	For a sample of the significant programs and project selected by the examiner, provide evidence that supports the completed test plans and related stakeholder communications.	Review the completed test documentation to ensure that plans were followed and that business process owners and end users participated in the testing.
BAI 04	Systems fail to meet current and future business needs due to inadequate planning for capacity, performance and availability.	BAI 04.01	The company has established a plan and review process for continuous performance and capacity monitoring of IT resources. Management ensures that contingency plan procedures are in place to properly address availability, capacity and performance of individual IT resources.	Provide a copy of the policies and procedures regarding performance and capacity management.	Review policies and procedures and interview key staff members involved in the development of the performance and capacity plan to verify that the appropriate elements (e.g., customer requirements, business requirements, cost, application performance requirements and scalability requirements) were considered during the development of the plan. Inquire of key staff members as to whether emergency problems have occurred in the recent past and, for those instances (if any), verify compliance with the contingency plan procedures to verify that they were effective.
		BAI 04.02	Solutions and services that are critical in the availability and capacity management process are evaluated as part of business impact analysis	Provide evidence to support the completion of business impact analysis procedures for key business units.	Verify that business impact analysis procedures for critical systems have been recently performed. Assess the results of these procedures to determine if business needs (performance and availability) are being adequately addressed.

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			procedures. Scenarios are defined and evaluated to address the likelihood that the systems' availability performance objective will not be achieved. The business line, function and regional leaders evaluate the impact of recovery scenarios on the business performance measures (e.g., revenue, product customer services).	Provide copies of the company's business continuity plan, disaster recovery and IT contingency plans.	Review the company's business continuity and disaster recovery plans. Verify that the IT continuity framework provides for: 1) Continuity management. 2) Defined roles, tasks and responsibilities of management, and internal and external service providers. 3) The ability to document, test and execute the disaster recovery and IT contingency plans. 4) Identification of critical resources, noting key dependencies. 5) Monitoring and reporting of the availability of critical resources, alternative processing. 6) The principles of backup and recovery.
		BAI 04.03	Capacity and performance plans are updated and reviewed by management periodically, and define current and forecasted performance, and are used for service trend analysis.	Obtain capacity and performance plans, including modeling techniques that define current and forecasted performance, capacity and throughput of the IT resources. Obtain evidence of periodic update and review by management.	Determine if a review of capacity and performance plans is performed. Assess if the review considers cost-justifiable capacity and performance based upon agreed-upon workloads, as determined by the SLAs.
		BAI 04.04	The IT operations team performs trend analysis reporting and provides management with monitoring and reporting	Provide trend analysis reports that identify any significant issues and variances.	Validate the effectiveness of continuous monitoring tools through the review of IT management's use of trend analysis reports.

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			information for availability, performance and capacity workload of all information-related resources.		
		BAI 04.05	The company maintains vendor product manuals that define: 1) an appropriate level of performance availability for processing and workloads; 2) corrective actions (e.g., shifting workload, prioritizing tasks or adding resources, when performance and capacity issues are identified); and 3) escalation procedures for swift resolution in case of emergency capacity and performance problems.	Provide capacity and performance reports and vendor manuals that take into account aspects such as normal workloads, contingencies, storage requirements and IT resource life cycles.	Review and assess items obtained for definition of corrective actions, appropriate level of performance availability and adequacy of escalation procedures.
BAI 06 & 07	A lack of proper change management threatens system stability and/or integrity.	BAI 06.01, BAI 06.03–BAI 06.04	The company has a process in place to record, authorize, manage, monitor and implement requests for changes. Procedures exist to ensure documentation is appropriately updated	Provide documentation regarding the company change-management process, including copies of any forms used in this process. Provide documentation of how management monitors open change	Verify that the company's procedures require a change request to be evaluated, authorized and tested. Review evidence of management's monitoring of open change requests Select a sample of completed changes to verify that documentation such as change requests, authorizations, business objective areas

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			and distributed to affected users and IT staff upon completion of change.	requests. Provide a current list of completed change requests, during the period under review.	impacted, prioritizations, deliverable dates, change descriptions, deliverables, testing, back-out plans, closures and documentation are properly included in accordance with company standards.
		BAI 06.02	The company has a separate process in place to handle emergency changes.	Provide documentation regarding the company's process to handle emergency change requests. Provide a copy of any forms used in this process.	Verify that access to make emergency changes is revoked in a timely manner. Verify that the company completes a post-implementation review on all emergency changes.
		BAI 07.01	The company has established standards for an implementation and backout plan.	Provide procedures and guidelines for implementation. Provide procedures in the event of implementation failure.	Select a sample of completed projects and verify that the company has documented implementation and backout procedures that meet company standards.
		BAI 07.02	The company has a defined process to ensure data is converted accurately and completely.	Provide procedures detailing system and data conversion. Provide a listing of data conversion projects.	Verify that the conversion procedures ensure that data is converted accurately and completely and can be recovered. Select a sample of conversion projects and confirm that data was validated and converted accurately.
		BAI 07.04	The company has established a test environment that is representative of the production environment and takes into consideration security,	Provide a description of the development, test and production environments.	Verify that production, test and development environments are appropriately segregated. Verify that the test environment has appropriate physical and logical access controls. Verify that changes cannot be made to the code

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			workloads and data quality.		in the test environment. Verify that the data used in the testing environment meets the company's security requirements. Verify that there are required approvals to move objects from the development environment to the test environment.
		BAI 07.05	The company performs testing in accordance with its defined plan prior to migration to the production environment.	Provide evidence of standard testing documentation, including copies of any forms used.	Select a sample of completed projects and verify that test plans and other testing evidence complied with testing standards and guidelines and were appropriately approved and review Verify that all relevant stakeholders are involved in the testing process and that changes were not implemented until the relevant stakeholders approved the testing results. Verify that testing performed considers security and performance (stress testing).
		BAI 07.06	The company has controls in place to ensure that changes are released into production in accordance with the implementation plan.	Provide evidence of controls that ensure production releases in accordance with the implementation plan	Review the company's implementation process. Select a sample of completed projects and verify that changes were released into production in accordance with the implementation plan.
		BAI 07.08	The company conducts a post-implementation review as outlined in its standards and as detailed in an individual implementation plan.	Provide evidence of post-implementation review procedures, including copies of any forms utilized in the process.	Review procedures to verify that a review is performed to address positives, negatives and lessons learned. Select a sample of completed projects and verify that the post-implementation review process is performed in accordance with

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					company standards and the individual implementation plan.
BAI 08	Systems cannot be properly managed and optimized due to inadequate documentation and training.	BAI 08.01–BAI 08.04	The company has policies and procedures in place that require technical, operational and user documentation and training to be available for all significant systems The company provides training as part of system development, implementation or modification projects	Provide evidence that appropriate technical, operational and user documentation and training is available for new system implementations or changes to existing systems.	For a sample of new or changed significant systems, verify that a training plan is incorporated into the project plan and that technical, operation and user documentation and training is provided by appropriate personnel.
BAI 10	A lack of configuration management threatens system stability, integrity and recovery.	BAI 10.01–BAI 10.05	The company has procedures in place over configuration management, which includes establishing and monitoring baselines for every system and service, in addition to the logging of any changes.	Provide a copy of policies, procedures and guidelines for configuration management.	Verify that senior management sets scope and measures for configuration management functions and assesses performance. Verify that a tool is in place to enable the effective logging and monitoring of configuration management information. Verify that configuration baselines for components are up-to-date, as defined and documented. Verify that configuration management data match the problem records. Verify that a policy is in place to ensure that all configuration items are identified, maintained and in accordance with policy.

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			Installed software is periodically compared to the policy for software usage to determine compliance with software licensing agreements.	Provide information regarding the procedures for, and results of, periodic reviews of software usage to the company's software policy and actual software licensing agreements.	Verify that periodic reviews are performed comparing software used to the company's policy for software usage to detect exceptions and the resolution of any discrepancies.

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PART TWO – EVALUATION OF CONTROLS IN INFORMATION TECHNOLOGY (IT)
WORK PROGRAM – DELIVER, SERVICE AND SUPPORT (DSS)

Risk Stmt #	Risk Statement	Ctrl #	Common Controls	Preliminary Information Request	Possible Test Procedures
DSS 01	The quality, timeliness and availability of business data is reduced due to an ineffective data-management process.	DSS 01.01	All data expected for processing is received and processed completely, accurately and in a timely manner, and all output is delivered in accordance with business requirements.	Provide evidence of the controls that ensure all data expected for processing is available and processed completely and in a timely manner.	Interview company personnel to verify the process controls over data management to determine whether there is responsibility over the availability and completeness of data and the timeliness and accuracy of data processing.
			Procedures are defined, implemented and maintained for IT operations.	Provide a copy of the policy and procedures for IT operations.	Review the standard IT operational procedures and verify the propriety and effectiveness of the procedures for abnormal operating system termination, the inclusion of a callout list in the case of emergency, etc. Verify that batch job duties and responsibilities for each computer operator exist along with shift schedules.
			The scheduling and completion of jobs is organized into a sequence, maximizing throughput and utilization to meet business requirements.	Provide a copy of the job run log showing batch job execution.	Verify that the log is reviewed on a routine basis and on a timely manner.
				Provide a copy of documentation showing contact information and codes for job failures.	Verify that procedures include points of contact in the case of job failures, along with a running list of job failure codes.
	The operation of outsourced IT services is not managed to maintain the	DSS 01.02	The company has a well-defined vendor-management process to ensure adherence to policies for security of	Provide a copy or description of the company's vendor-management process.	Review the company's vendor-management process and verify that it adheres to best practices.
				Provide copies of SLA	Review the SLA for key critical outsourced

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	protection of enterprise information and reliability of service delivery.		information, operational business and IT processing requirements and integration of critical processes.	and SSAE 18 SOC 2 reports for each key or critical outsourced service provider.	services and verify that the contracts include a right-to-audit provision. Interview personnel and verify that the company monitors SSAE 18 SOC 2 reports for its critical outsourced processes and services. Review a sample of SOC 2 reports and verify that the effectiveness of controls was attested to by the auditor. If key control failures were identified by the auditor in the SOC 2 report, discuss with personnel how the control failure is being compensated at the company.
	Lack of infrastructure monitoring may result in the inability to detect and/or recognize security incidents.	DSS 01.03	IT infrastructure activity is logged with sufficient detail to reconstruct, review and examine operational activities; this activity is monitored on a regular basis.	Provide a copy of reports used to monitor the IT infrastructure.	Verify that the infrastructure assets that need to be monitored are identified based on service criticality and the relationship between configuration items and services that depend on them. Verify that automated tools are used to monitor IT infrastructure and whether alerts, reports and logs are generated for significant events.
	Inadequate physical and environmental controls may result in unauthorized access and inadequate protection of data.	DSS 01.04–DSS 01.05	The data center contains proper physical and environmental controls to protect the equipment, data and personnel located within.	Provide information regarding the physical and environmental controls in place at the company's data center and other sensitive IT sites.	Tour the data center, inspect documents and interview the appropriate personnel to verify that physical security and environmental controls are in place and monitored. Verification may include the following: Physical site risk: IT equipment have been selected through consideration of such issues as geographic position, neighbors, infrastructure and risks (e.g., theft, temperature, fire, smoke, water, vibration, terrorism, vandalism, chemicals and explosives)

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					A process is defined and implemented that identifies and monitors the potential risks and threats to the organization's IT sites and assesses the potential business impact on an ongoing basis, taking into account the risks associated with natural and man-made disasters. A policy is defined and implemented for the physical security and access control measures to be followed for IT sites and that the policy is regularly reviewed to ensure that it remains relevant and up-to-date. Access to information about sensitive IT sites and their design plans are restricted to essential personnel. External signs and other identification of sensitive IT sites are discreet and do not obviously identify the site from outside. Organizational directories/site maps do not identify the location of sensitive IT sites. A process supported by the appropriate authorization is defined and implemented for the secure removal of IT equipment. IT facilities are situated and constructed in a way to minimize and mitigate susceptibility to environmental threats. Suitable devices are in place to detect environmental threats. Evaluate the

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					effectiveness of continuous monitoring performed through these devices. Alarms or other notifications are raised in case of an environmental exposure, procedures in response to such occurrences are documented and tested, and personnel are adequately trained. A process exists that examines the IT facilities' needs for protection against environmental conditions and power fluctuations and outages, in conjunction with other business continuity planning procedures. Verify that a policy and procedure exists for recording, monitoring, managing, reporting and resolving physical security incidents, in line with the overall IT incident management process. Uninterruptible power supplies (UPS) are available, regularly tested and meet business continuity requirements. In facilities housing sensitive IT systems, more than one power supply entry is available and the physical entrance of power is separated. A process is in place to ensure that IT sites and equipment are maintained per the supplier's recommended service intervals and specifications.

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Risk Stmt #	Risk Statement	Ctrl #	Common Controls	Preliminary Information Request	Possible Test Procedures
					IT sites and server rooms are kept clean and in safe condition.
DSS 02	Inadequate or ineffective response and resolution to user requests and incidents could result in interruption of services or inefficient usage of technology solutions.	DSS 02.01	The company has a defined security incident response plan process that clearly communicates characteristics of potential security incidents so they can be properly classified, treated, and addressed.	Provide a copy of the company's security incident response plan including escalation procedures.	Verify the existence and completeness of a cybersecurity incident response plan. Verify that a computer emergency response team (CERT) exists to recognize and effectively manage security emergencies. The following areas should exist as part of an effective CERT process: 1) Incident handling – General and specific procedures and other requirements to ensure effective handling of incidents, including prioritization, and reported vulnerabilities. Determine if there are procedures related to handling of cyber-security incidents. 2) Communications – Requirements detailing the implementation and operation of emergency and routine communications channels amongst key members of management.
				Provide a list of security incidents during the period under review.	Select a sample of incidents to verify that the security incident management process includes: 1) Event detection. 2) Correlation of events and evaluation of [illegible] incident. 3) Resolution of threat, or creation and escalation of an appropriate work order. 4) Criteria for initiating the organization's CERT process. 5) Verification and required levels of documentation of the resolution. 6) Post-remediation analysis. 7) Work order/incident closure.
				Provide evidence of the	Verify that the security incident management

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				company's security incident tracking process.	process appropriately interfaces with key organizational functions, including the help desk, external service providers and network management.
			Response activities are coordinated with internal and external stakeholders and law enforcement agencies, as appropriate.	Provide a copy of the company's incident response plan and procedures.	Review the company's incident response plan and procedures and verify whether: • Personnel know their roles and order of operations when a response is needed. • Events are reported consistent with established criteria. • Information is shared consistent with response plans. • Coordination with stakeholders occurs consistent with response plans. Voluntary information sharing occurs with external stakeholders in accordance with the organization's data classification criteria to achieve broader cybersecurity situational awareness.
			The company has established procedures for performing a forensic investigation of the security incident or crime (if deemed necessary). Investigations are performed by a qualified professional trained in incident detection and management (e.g., certified forensic	Provide a copy of the company's computer forensic investigation procedures.	Review and confirm whether the company's procedures follow a process of identifying, preserving, analyzing and presenting digital evidence in a manner that is acceptable in any legal proceedings (i.e., a court of law).

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			computer examiner, certified ethical hacker, etc.).		
			The company incorporates lessons learned from ongoing incident handling activities into incident response procedures, training and testing, and implements the resulting changes into the risk management controls (APO 12).	Provide information regarding lessons learned from current and previous incident response activities and how they are incorporated into the organization's response activities.	Verify that lessons learned are incorporated into the security incident response plan and verify, where appropriate. Verify the communication of the results of post-remediation analysis to management and the board of directors or board committee, thereof, as appropriate.
		DSS 02.02–DSS 02.03	The company has a service function to record, classify and prioritize requests and incidents (e.g., service desks).	Provide a copy of the policy and procedures for the service function.	Verify that the processes and tools are in place to register incidents, status and actions for resolution. Review the standards for communication of incidents and verify that they were complied with.
				Provide a listing of open and closed user reported incident records.	Review a sample of open and closed customer incidents to verify compliance with the process and service commitments. For the sample selected, verify that all resolved incidents are described in detail, including a detailed log of all steps taken to resolve the incident.
				Provide documentation on the workflow used to handle incidents	Review procedures for reporting significant incidents to management. Verify with management that significant incidents are reported to them.
		DSS 02.07	A reporting function has	Provide information on	Verify that a process is in place to evaluate the

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			been established to monitor and measure service performance, service response times and user satisfaction with the service function.	how the performance of the service function is monitored.	performance of the service function in the areas of response time and user satisfaction.
DSS 03	The company has an ineffective problem-management process that increases operating costs and reduces system availability, service levels and customer satisfaction.	DSS 03.01	The company maintains problem-management policies and procedures, including escalation triggers, with adequate audit trails and analysis to identify, report and classify incidents by category, impact, urgency and priority.	Provide a copy of the policy and procedures used to identify, classify and track incidents.	Verify that adequate processes supported by appropriate tools are in place to identify and monitor incidents. For TPA problem management, review SLAs, SSAE 18, contracts, etc.
		DSS 03.02	The company has implemented a problem-management system that identifies and initiates solutions addressing the root cause of the problem and provides adequate audit trail facilities that allow tracking, analyzing and determining the root cause of all reported problems.	Provide a copy of the company's problem-management policies and procedures.	Review the company's policies and procedures to verify that problems were tracked and solutions addressed the root cause of problems.
				Provide a listing of all problem tickets for the period under review. The listing should include the ticket number, description of the problem, date the problem was reported, date the problem was closed and, if open, current priority.	Select a sample of tickets for appropriate prioritization, identification of root cause, timely completion, documentation of actions taken and any necessary approvals.
				Provide evidence of the company's monitoring of the problem-management	Review the evidence to verify that the company (ideally business management) is monitoring the timeliness and the quality of the selected

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Risk Stmt #	Risk Statement	Ctrl #	Common Controls	Preliminary Information Request	Possible Test Procedures
				system.	problem solutions.
		DSS 03.03–DSS 03.04	Problem disposition procedures are in place to address error resolution.	Provide a listing of all problem tickets opened during the period under review.	Review the log for sequential gaps and identify the causes. Select a sample of problems and verify, through interviews with stakeholders, that they were informed completely, and in a timely manner, of problem remediation activity and closures.
		DSS 03.05	Change management is integrated with problem management to ensure effective management of problems and to enable improvements.	Provide a copy of the company's incident management policy.	Review the policy to verify that the problem-management process is integrated with the change-management process to ensure that incidents are addressed. Select a sample of problem tickets to verify that there was an associated change ticket.
DSS 04	Inadequate continuity management may result in the inability to ensure critical business functions.	DSS 04.01–DSS 04.02, DSS 04.05	The company has a defined and documented framework that provides: 1) A consistent company-wide process for IT continuity management. 2) A planning process that creates the rules and structures to document, test and execute the IT disaster recovery and business continuity plans. 3) The identification of critical resources, noting key dependencies, the monitoring and reporting of the availability of	Provide copies of IT business continuity plans, including disaster recovery plan procedures. Provide a copy of the business impact analysis (BIA) study. Provide a copy of contracts and SLAs supporting the IT continuity plan. Provide the procedures and evidence for testing and periodic plan updates.	Verify that a company-wide business continuity plan is in place. As part of this overall plan, an IT business continuity plan should be completed to include: 1) BIA study. 2) Prioritized recovery strategy. 3) Necessary operational support. 4) Any compliance requirements. 5) Comprehensive and appropriate disaster recovery plan. Possible elements of the disaster recovery plan that need to be verified may include: 1) The conditions and responsibilities for activating and/or escalating the plan. 2) A prioritized recovery strategy, including the necessary sequence of activities. 3) Minimum recovery requirements to maintain adequate business operation service levels with diminished resources.

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Risk Stmt #	Risk Statement	Ctrl #	Common Controls	Preliminary Information Request	Possible Test Procedures
			critical resources, alternative processing, and the principles of backup and recovery. Change control procedures are in place to ensure that the IT continuity plan is kept up-to-date and continually reflects actual business requirements.		4) Emergency procedures. 5) IT processing resumption procedures. 6) A maintenance and testing schedule. 7) Awareness, education and training activities. 8) Responsibilities of individuals. 9) Regulatory considerations. 10) Critical assets, resources and up-to-date personnel contact information needed to perform emergency, fallback and resumption procedures. 11) Alternative processing facilities, as determined within the plan. 12) Alternative suppliers for critical resources. 13) Chain of communications plan. 14) Roles, tasks and responsibilities defined by SLAs and/or contracts for internal and external service providers. Verify that plans are accessible to authorized personnel. Verify that the plans are up to date and all copies of the IT business continuity and disaster recovery plans are updated with revisions and are stored on- and off-site.
		DSS 04.04	The company tests the IT business continuity and disaster recovery plans on a regular basis to ensure that IT systems can be effectively recovered. The company has	Provide evidence of management's review of continuity recovery test results. Provide evidence of	Verify that IT continuity tests are scheduled and completed on a regular basis and after significant changes to the IT infrastructure or business applications. Verify that test results are reported to management and that necessary changes are made.

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Risk Stmt #	Risk Statement	Ctrl #	Common Controls	Preliminary Information Request	Possible Test Procedures
			policies in place to ensure that test results and deficiencies are communicated to management and the plan is updated as required.	continuity test deficiency resolutions.	
		DSS 04.07	Adequate critical backup media, documentation and other IT resources necessary for IT recovery and continuity plans are stored off-site in a secure location.	Provide a copy of policies and procedures relating to the backup of systems and data, including copies of recovery procedures for off-site backups and information about off-site backup locations and/or service providers.	Inquire and verify that data is protected and secured when taken off-site and while in transit to the storage location. Inquire and verify that the backup facilities are not subject to the same risks as the primary site.
				Provide an inventory of backups and media and provide the company's periodically validated the inventory.	Inquire and verify that an inventory of backups and media exists and that the company verifies its accuracy. Inquire and verify that the backup media contain all information required by the IT business continuity and disaster recovery plans.
				When outsourcing significant systems or functions, provide a copy of contracts and SLAs supporting the IT business continuity and disaster recovery plans.	Verify data replication product being used and review documentation from testing the utilization of the replicated data to recover the system.
		DSS 04.08	Effective and efficient data storage, retention and archiving policies and procedures are	Provide a copy of the data retention policy.	Review retention periods for data and verify that they are in line with contractual, legal and regulatory requirements.

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Risk Stmt #	Risk Statement	Ctrl #	Common Controls	Preliminary Information Request	Possible Test Procedures
			available to meet business objectives.		
			Policies and procedures are in place to maintain an inventory of stored and archived media.	Provide a copy of the media inventory and data dictionary for the warehouses supporting all financially significant systems.	Review the media inventories and, on a sample basis, verify that media on the inventory list can be identified and items in storage can be traced back to the inventory. On a sample basis, verify that external labels correspond with internal labels, or otherwise validate that external labels are affixed to the correct media.
				If the company uses third-party vendors to provide off-site media storage, provide copies of the service contracts.	Verify, through a review of contracts, that the company's access to its storage media cannot be restricted by the service provider.
			The company has procedures in place for backup and restoration of systems, applications, data and documentation that are consistent with its business requirements and continuity plan.	Provide evidence that backup and storage equipment for critical systems, applications, data and related documentation are periodically reviewed and aligned with risks and the continuity plan.	Verify that critical systems, applications, data and related documents that affect business operations are periodically reviewed for alignment with the risk management model and IT service continuity plan. Verify that adequate policies and procedures for backup of systems, applications, data and documentation exist and consider factors including: 1) Frequency of backups. 2) Type of backups (e.g., disk mirroring, external media, full, incremental, etc.). 3) Automated vs. manual backups. 4) Data types (e.g., voice, optical). 5) Creation of logs. 6) Critical end-user computing data (e.g., spreadsheets).

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Risk Stmt #	Risk Statement	Ctrl #	Common Controls	Preliminary Information Request	Possible Test Procedures
					7) Physical and logical location of data sources. 8) Security and access rights. 9) Encryption.
			The post-resumption review has been performed after testing or an incident and the BCP updated as a result.	Provide evidence of recent testing of backup processes or post-resumption processes to verify all components of backups were effectively restored.	Verify that sufficient restoration tests have been performed periodically to ensure that all components of backups can be effectively restored. Verify post-resumption review was performed and the BCP updated as a result.
DSS 05	The company's business is threatened by the impact of operational information security vulnerabilities and incidents.	DSS 05.01	Preventative, detective and corrective measures are in place (especially up-to-date security patches and virus control) across the organization to protect information systems and technology from malware (e.g., viruses, worms, spyware, spam).	Provide a copy of the company's policies and procedures over malicious software. Identify how the policy is communicated throughout the organization. Provide an inventory of server and desktop virus protection tools including details of the current patch level.	Verify that a malicious software prevention policy is established, documented and communicated throughout the organization and is included in the security policy. Select a sample of the company's servers and validate that they are updated to the current patch level. Verify that automated controls have been implemented to provide virus protection and that violations are appropriately communicated. Inquire of key staff members whether they are aware of the malicious software prevention policies and their responsibility for ensuring compliance.
				Provide a copy of the company's virus protection tool installation and update procedures including	From a sample of workstations, verify that a virus protection tool has been installed and includes virus definition files and the last time the definitions were updated.

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Risk Stmt #	Risk Statement	Ctrl #	Common Controls	Preliminary Information Request	Possible Test Procedures
				information regarding version and patch-level used.	Verify that the protection software is centrally distributed (version and patch-level) using a centralized configuration and change-management process. Verify that information on new potential threats is regularly reviewed and evaluated and, as necessary, manually updated to the virus definition files. Verify that incoming email is filtered appropriately against unsolicited information.
			A vulnerability management plan is developed and implemented.	Provide a copy of the company's vulnerability management plan.	Verify that a vulnerability management plan is in place and has the following attributes: (1) Utilizes standardized vulnerability scanning tools. (2) Utilizes industry standard vulnerability scoring, such as the common vulnerability scoring system (CVSS). (3) Regularly scans all end-points, servers, network devices, database management systems and web applications. (4) Includes appropriate service level agreements for remediation of discovered vulnerabilities. (5) Incorporates a mechanism for reporting and tracking all outstanding vulnerabilities.
		DSS 05.02	Business, risk and compliance requirements are translated into an overall IT security policy/procedure that takes into consideration the IT infrastructure and	Provide a copy of the information security policy and IT security governance documentation, including: 1) An external communications security	Verify that a detailed information security policy, as well as standards and procedures exist, which properly address the following: 1) Responsibilities of the board, executive management, line management, staff members and all users of the company's IT infrastructure. 2) A security compliance policy.

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Risk Stmt #	Risk Statement	Ctrl #	Common Controls	Preliminary Information Request	Possible Test Procedures
			the security culture.	policy. 2) A firewall policy. 3) An email security policy. 4) An agreement to comply with IT policies. 5) A laptop/desktop computer security policy. 6) An Internet usage policy.	3) Management risk acceptance (security noncompliance acknowledgement, including noncompliance to security policies with supporting policy exception waiver approved by senior management). 4) An external communications security policy. 5) A firewall policy. 6) An email security policy. 7) An agreement to comply with IT policies. 8) A laptop/desktop computer security policy. 9) An Internet usage policy. 10) Procedures to implement, monitor, update and enforce the policies and standards. 11) Staffing requirements. 12) Security awareness and training. 13) Investments in required security resources. 14) Cyber-security. Verify that the IT security policy considers IT tactical plans, data classification, technology standards, security and control policies, risk management and external compliance requirements. Verify that policy exceptions are authorized, tracked, aggregated and reviewed on a regular basis for appropriateness.
			Security policies and procedures are documented and communicated to stakeholders and users.	Provide evidence of user review and acknowledgement of the company's security policies.	Verify that management are required to periodically review and acknowledge the company's security policies. Assess the level of awareness of both the content of the security policies and the importance of compliance with policies by

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Risk Stmt #	Risk Statement	Ctrl #	Common Controls	Preliminary Information Request	Possible Test Procedures
					employees.
			Security techniques and related management procedures (e.g., firewalls, security appliances, network segmentation, intrusion detection, etc.) are used to authorize access and control information flows from and to networks.	Provide a copy of network security standards and procedures, including change-management procedures and required documentation.	Verify that a network security policy (e.g., provided services, allowed traffic, types of connections permitted) has been established and is maintained. Verify that procedures and guidelines for administering all critical networking components (e.g., core routers, DMZ, VPN switches) are established and updated regularly by the key administration personnel and changes to the documentation are tracked in the document history.
			Sensitive data exchanged over a trusted path or media are provided with controls to provide authenticity of content, proof of submission, proof of receipt and non-repudiation of origin.	Provide an inventory of methods of exchanging sensitive data encryption tools used by the company.	Verify that data transmissions outside the organization require encrypted format prior to transmission. Verify that sensitive data processing is controlled through application controls that validate the transaction prior to transmission.
		DSS 05.04–Logical Access	All users (internal, external and temporary) and their activity on IT systems (business application, IT environment, system operations, development and maintenance) are uniquely identifiable.	Provide a copy of the company's user access policy and procedures for adding, modifying and deleting users, including management approvals.	Verify that security practices require users and system processes to be uniquely identifiable and systems to be configured to enforce authentication before access is granted. Verify that the company's password rules are consistent with the criticality and sensitivity of the data for which they afford access.
			User identities are enabled via authentication mechanisms including	Provide a description of the company's authentication method for system and application	Verify that authentication control mechanisms are utilized for controlling logical access across all users, systems, processes and IT resources, for in-house and remote managed users.

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Risk Stmt #	Risk Statement	Ctrl #	Common Controls	Preliminary Information Request	Possible Test Procedures
			multi-factor authentication for remote access, as appropriate based on the sensitivity of the information which may be accessed.	access.	Multi-factor authentication is required for remote access.
			Policies and procedures are available to classify data and protect information assets under control of the business.	Provide policies and procedures that describe the company's data classification program.	Verify the IT security policy considers IT tactical plans, data classification, technology standards, security and control policies, risk management and external compliance requirements.
			User access rights to systems and data are in line with defined and documented business needs. This includes access rights granted to service providers.	Provide a listing of data classification for significant data elements.	If predetermined and preapproved roles are utilized to grant access, verify that the roles clearly delineate responsibilities based on least privileges and ensure that the establishment and modification of roles are approved by process owner management. Verify that systems, applications and data have been classified by levels of importance and risk, and if process owners have been identified and assigned.
			User access rights are requested by user management, approved by system owners and implemented by the security-responsible person to grant, limit and revoke access to systems, applications and data.	Provide a listing of user access roles, including systems and application access.	Verify that procedures exist to periodically assess and recertify individual user system and application access and authorities.
				Provide a listing of hires, transfers and terminations.	Verify that logical access rights are appropriately authorized, administered and revoked.
		DSS 05.05 –	Procedures are defined	Provide a copy of the	Verify that physical access rights are

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Risk Stmt #	Risk Statement	Ctrl #	Common Controls	Preliminary Information Request	Possible Test Procedures
		Physical Access	and implemented to grant, limit and revoke access to premises, buildings and areas, according to business needs, including during emergencies.	procedures for system and facility access.	appropriately authorized an administered. This may include the following: 1) A process is in place that governs the requesting and granting of access to the computing facilities. 2) Formal access requests are completed and authorized by management of the IT site, the records are retained, and the forms specifically identify the areas to which the individual is granted access. This may be verified by observation or review of approvals. 3) Procedures are in place to ensure that access profiles remain current. Verify that access to IT sites (server rooms, buildings, areas or zones) is based on job function and responsibilities. 4) A policy exists requiring visitors to be escorted at all times by a member of the IT operations group whilst on-site, and individuals who are not wearing appropriate identification are pointed out to security personnel. 5) Access to sensitive IT sites is restricted through perimeter restrictions, such as fences/walls and security devices on interior and exterior doors. 6) Devices record entry and sound an alarm in the event of unauthorized access. Examples of such devices include badges or key cards, key pads, closed circuit television and biometric scanners.
				Provide a copy of the facility access logs.	Verify that the site has a process to log and monitor all entry points to IT sites, registering all visitors, including contractors and vendors, to the site.
		DSS 05.06	Appropriate accounting	Provide a copy of the	Verify that procedures governing the receipt,

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Risk Stmt #	Risk Statement	Ctrl #	Common Controls	Preliminary Information Request	Possible Test Procedures
			practices and inventory management over sensitive IT assets have been established.	policy and procedures for receipt, removal and disposal of special forms (e.g., check stock and other negotiable instruments or special purpose printers).	removal and disposal of special forms within and out of the organization are adequate and are being followed.
				Provide a copy of the last review of the access to sensitive assets.	Verify that the access log to sensitive assets is periodically reviewed. Verify that procedures to gain, change and remove access to sensitive assets are adequate and are being followed.
			Procedures are in place to ensure that business requirements for the protection of sensitive data and software are met upon disposal or transfer of data and hardware (endpoints, mobile devices, network devices, servers, portable media and hard drives).	Provide a copy of policies, procedures, and guidelines relating to the disposal of IT equipment and/or storage media.	Verify that responsibility for the development and communication of policies on disposal of media are clearly defined.
				Provide documentation to show that storage media disposed or transferred have been sanitized.	Verify that equipment and media containing sensitive information are sanitized prior to reuse or disposal in such a way that data marked as "deleted" or "to be disposed" cannot be retrieved (e.g., media containing highly sensitive data have been physically destroyed).
				Provide a copy of the current media inventory and the media disposal log.	Verify that disposed equipment and media containing sensitive information have been logged in a manner in an audit trail. Verify that there is a procedure to remove active media from the media inventory list upon disposal. Verify that the current inventory has been updated to reflect recent disposals in the log.
			Physical devices,	Provide a copy of the	Verify that all devices, software and

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Risk Stmt #	Risk Statement	Ctrl #	Common Controls	Preliminary Information Request	Possible Test Procedures
			software platforms and applications within the organization are inventoried.	policy and procedures detailing the inventory requirements over devices, software platforms and applications.	applications are classified and inventoried and then tracked with such metrics as; comprehensive deployment counts and versioning. Tracking should also consider the location and responsible individuals for items listed in the inventory.
		DSS 05.02	The company has an established company-wide IT security baseline and periodically tests and monitors its IT security implementation for compliance with that baseline.	Provide information regarding the process in place to log security events and how information is reviewed.	Verify that the IT security management function has been integrated within the organization's project-management initiatives to ensure that security is considered in development, design and testing requirements to minimize the risk of new or existing systems introducing security vulnerabilities.
			The company has [illegible] logging and monitoring functions enabled for early detection and/or prevention of abnormal activities that may need to be addressed.	Provide information regarding the process in place to log security events, including how information is aggregated and correlated from multiple sources. Provide information regarding any network vulnerability tests or penetration tests performed during the period under examination. The information should include the findings along with the company's actions to address the findings.	Review event logs and/or reports evidencing the review of security events, including aggregated and correlated events, to ensure that network activity is being properly monitored. This should include consideration of activity generated by third-party service providers. Note that the extent of testing (and associated requests) should be focused on material events. Procedures performed may include consideration of the manner in which management classifies events to determine that material events are appropriately identified. Review the results of the vulnerability and penetration tests to identify the findings and verify that the company has addressed items with high or critical severity.
			Threat and vulnerability	Provide information	Review examples of how information received

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Risk Stmt #	Risk Statement	Ctrl #	Common Controls	Preliminary Information Request	Possible Test Procedures
			information received from information-sharing forums and sources (e.g., Financial Services Information Sharing and Analysis Center, etc.) is used in developing a risk profile.	regarding the process to integrate information received from information-sharing forums.	has resulted in changes to the broader security framework.
			The company has a process in place to integrate acquired entities/systems. The process includes adequate security assessment and threat analysis of existing IT systems of acquired entities.	Provide information regarding the process to integrate acquired entities/systems.	Verify that security assessment and threat analysis was properly executed for any entities acquired. Ensure that issues identified through this process are properly mitigated.
			The company has implemented integrity-checking mechanisms (e.g., parity checks, cyclical redundancy checks, cryptographic hashes, etc.) and associated tools to monitor the integrity of information systems and hosted applications. Exceptions and incidents are logged and investigated.	Provide information regarding integrity-checking mechanisms used by the company to verify software, firmware and information integrity.	Verify that integrity-checking mechanisms are in place for critical systems and applications. For a sample of exceptions/incidents, verify that they are properly investigated and resolved.
			The company defines acceptable and unacceptable mobile	Provide information regarding the process for detecting and preventing	Verify that a baseline of approved mobile code has been established and that detection mechanisms which block unauthorized mobile

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			code, establishes usage restrictions and implementation guidance for acceptable mobile code, and monitors use of mobile code within the information system.	the execution of unauthorized mobile code.	code execution are in place.
			Protections against data leaks are implemented.	Provide information regarding the data loss prevention (DLP) program designed to detect and prevent protected information from leaving the company.	Verify that a DLP program is in place that includes: (1) Detective and blocking technology that regularly scans network traffic for protected information and blocks the transmission and alerts security personnel. (2) Safeguards against the use of unauthorized or unencrypted portable media. (3) Safeguards against unauthorized screen capture technology. (4) Safeguards against unauthorized use of instant messaging. (5) Prohibits the use of unauthorized file transport applications. (6) Provides routine user awareness training.

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PART TWO – EVALUATION OF CONTROLS IN INFORMATION TECHNOLOGY (IT) WORK PROGRAM – MONITOR, EVALUATE AND ASSESS (MEA)

Risk Stmt #	Risk Statement	Ctrl #	Common Controls	Preliminary Information Request	Possible Test Procedures
MEA 01	The company does not properly identify and address IT performance and conformance deficiencies.	MEA 01.01–MEA 01.04	The company has adopted and implemented a formalized monitoring framework to define the scope, methodology and processes to be followed for measuring IT's solution, service delivery and contribution to the company, including tracking corrective actions to address anomolies.	Provide evidence of the policies and procedures over IT performance monitoring including key performance metrics (KPIs). Provide a listing of the reports used to monitor IT performance.	Evaluate whether the company's IT monitoring framework: 1) Is consistent with key IT processes and business goals and objectives. 2) Establishes a balanced set of performance targets that are approved by the business and other relevant stakeholders. 3) Defines benchmarks and targets to be used for comparison. 4) Requires periodic reviews of performance against targets. 5) Analyzes the cause(s) of any deviations, and initiates remedial action to address the underlying causes. Select a sample of the monitoring reports to evaluate whether the company is effectively monitoring and addressing IT performance.
MEA 02	The company does not identify and address internal control deficiencies related to IT systems.	MEA 02.01	A process has been implemented to continuously monitor benchmark and improve the IT control environment and control framework to meet organization objectives.	Provide a copy of internal control monitoring activities including control self-assessments, SOX-related control reviews, independent controls reviews by consultants/contractors (including SOC reporting if the organization provides outsourced services) and internal	Review internal control monitoring activities for identification of control deficiencies, remediation and reporting.

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Risk Stmt #	Risk Statement	Ctrl #	Common Controls	Preliminary Information Request	Possible Test Procedures
				audit.	
				Provide a copy of the internal audit charter, mission statement and reporting relationships.	Review a copy of the internal audit charter, mission statement and reporting relationships to verify independence and objectivity of the internal audit function.
				Provide a listing of all internal audit reports, projects and reviews conducted (completed or not) during the examination period.	Review the listing of all internal audit reports, projects and reviews conducted (completed or not) during the examination period to ascertain the breadth and depth of the function.
				Provide a copy of all IT internal audit reports for the period under review.	Review all IT internal audit reports covering the examination period to ascertain the breadth and depth of the function. Verify that appropriate senior management attention was given to all significant IT findings and that issues were appropriately resolved.
				Provide a copy of the internal audit organizational chart.	Verify that the staffing of the internal audit unit is sufficient to accomplish the corporate mission.
				Provide a listing of IT specialists in the internal audit unit including background information on such as education, certifications and experience.	Verify that the education, certifications and experience of the IT specialists in the internal audit unit enable the accomplishment of the corporate mission.
MEA 03	IT processes and IT-supported business processes are not compliant with applicable laws,	MEA 03.01–MEA 03.02	A review process has been implemented to identify on a continuous basis changes in local and international laws, regulations and other	Provide a copy of procedures to verify that legal, regulatory and contractual obligations impacting IT are reviewed.	Verify that procedures are in place to ensure that legal, regulatory and contractual obligations impacting IT are reviewed. These regulatory compliance procedures should: 1) Identify and assess the impact of the applicable legal or regulatory requirements

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Risk Stmt #	Risk Statement	Ctrl #	Common Controls	Preliminary Information Request	Possible Test Procedures
	regulatory and other contractual requirements.		external requirements that must be complied with for incorporation into the organization's IT polices, standards, procedures and methodologies.		relevant to the IT organization. 2) Update the associated IT policies and procedures affected by the legal and regulatory requirements. 3) Include areas such as laws and regulations for electronic commerce, data flow, privacy, internal controls, financial reporting, industry-specific regulations, intellectual property copyright, and health and safety.
				Provide evidence that the company's IT policies and procedures have addressed all relevant legal, regulatory and contractual obligations.	Verify that the company's evidence documents their process to ensure that external obligations are addressed in IT policies and procedures.
		MEA 03.03–MEA 03.04	A procedure has been implemented to review and report compliance of IT policies, standards, procedures and methodologies with applicable legal and regulatory requirements.	Provide a copy of the position description for the chief compliance officer, including IT compliance officer if in place.	Verify that the organization has a chief compliance officer or equivalent, and review a copy of the job description for this position for adequacy.
				Provide a copy of the IT organization policies, standards, procedures, regulatory review plan and procedures.	Verify that a review of the IT organization policies, standards and procedures is conducted periodically to address any non-compliance (legal and regulatory) gaps identified (this can be included in the risk assessment process).
				Provide a copy of compliance documentation from all financially significant third-party service providers.	Verify that policies and procedures are implemented to ensure that contract with third-party service providers require regulator confirmation of compliance (e.g., receipt of assertions) with applicable laws, regulations and contractual commitments.

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EXHIBIT C
IT REVIEW STANDARD SUMMARY MEMORANDUM

A summary memorandum should be developed by the IT examiner to communicate the results of the IT review to the examiner-in-charge, or any other users. Some of the topics the IT examiner may want to consider incorporating into the summary memorandum are included in the illustration below, along with a brief description of information that should be discussed relating to each topic. This document should provide sufficient detail of the results of the IT review for use during the financial condition examination.

Salutation

This section should be in any format the state deems appropriate for its purposes. At a minimum, all states that are placing reliance on the IT review should be included in the distribution of this memo.

Background and Scope

This section should include an introductory paragraph identifying the following: companies under examination (domiciliary state and type may be helpful), the exam as-of date and time period under examination, where the work was performed, when the work was performed, and who performed the work.

Summary of Control Environment

This section should provide a summary description of the IT environment and the general IT controls assessed during the IT review. This section should also provide a general description of the insurer's overall processes and controls, including access controls, in place to protect sensitive information. This section should also include discussion of any breaches identified during the period under exam.

Work Performed

This section of the memo should provide an overview of the work performed to evaluate general IT controls throughout the IT review process, as well as the reliance placed on external sources (e.g., Model Audit Rule documentation/testing, Sarbanes-Oxley documentation, external audit work, etc.).

Summary / Detail of Findings (Including Cybersecurity Related Findings)

This section should provide a summary description of the findings that were identified while performing the IT review. These findings may include areas that affect the company's current operations; areas that will be relevant for future examinations; or areas of recommendation for the company to consider. The IT examiner should document the recommendation and impact of the finding on the financial examination and provide reference to the supporting detail located in the completed Exhibit C, Part Two (or similar document). The following table(s) or similar format may be used.

Findings

IT Review Finding	Recommendation for Company	Impact on Financial Examination	Supporting Detail Reference

Conclusion/Results of IT General Control Review

This section should document the conclusion/results of the IT general control review. Based on the impact of the findings, the IT examiner should determine whether the IT general control environment is effective and would, therefore, indicate

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that IT risks have been sufficiently mitigated to allow for reliance on general IT controls and testing of application controls in Phase 3. If the IT general control environment is not effective, the examiner would be required to perform additional testing in later phases of the exam before relying on system-generated reports or controls in place at the insurer. For additional guidance regarding the conclusion of the IT general control review refer to Section 1, Part III, A – General Information Technology Review.

Note: The IT Examiner should provide a conclusion on the effectiveness of the IT General Controls using the terminology prescribed by the Handbook (Effective or Ineffective). Using alternate language may leave the Financial Examiner in an unclear position on whether ITGC's can be relied upon and may lead to inefficiencies later in the examination process.

Meeting with Examiner-In-Charge and Other Financial Examiners

This section should document the date and time of the meeting with the EIC and other examiners (e.g., examiners from other states participating in the financial examination) that was conducted to discuss the findings and results of the IT review.

Assistance on the Financial Examination

This section should identify the remaining areas of the financial examination in which the IT review team will be asked to provide assistance. This may include testing application controls in conjunction with Phase 3 of the risk-focused examination, performing data mapping or ACL testing, and/or assisting with drafting the examination report and/or management letter.

Completed Exhibit C, Part Two (or Similar Document) and Supporting Documentation

A completed IT Review Work Program should be referenced here and provided to the EIC. Detail findings should be noted within the work program and referenced in the "Detail of Findings" section above.

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EXHIBIT D
PLANNING MEETING WITH THE FINANCIAL ANALYST

Overview

This document is intended as an optional tool highlighting items that may be discussed during a planning meeting with the assigned financial analyst in support of the financial exam process. This meeting should ensure that the examiner both understands the company that will be examined and also receives details on work that has already been performed in supervising the company's operations. An effective exchange of information will promote efficiencies in the financial examination process by allowing the examiner to leverage the knowledge and work performed by the financial analyst. It may also prove useful to supplement this meeting with a discussion of the Exam Planning Questionnaire (Exhibit B) so that the analyst can review during the discussion to highlight or indicate if a document being requested has been obtained and/or reviewed by the department. Although this exhibit focuses on discussions with the assigned analyst, it may be appropriate to incorporate this discussion into a broader planning meeting with members of department management and representatives from other areas of the department. However, if such an approach is taken, it should not reduce or diminish the level of discussion between the analyst and the examiner.

Given the importance of the Insurer Profile Summary (IPS) in communicating the results of the Department's Financial Analyst's review of the company's operations, the planning meeting with the analyst is intended to generally follow the format of the IPS Template.

Depending on the significance of operations at the group level, the examiner should consider whether additional agenda items should be added to focus on risks posed and discussed in the Group Profile Summary that are relevant for consideration during the examination.

NOTE: The exhibit was prepared to assist examiners in obtaining a general knowledge of the company through the meeting with the analyst. The examiner leading the discussion should not rely exclusively on these topics and should tailor agenda items based on knowledge of the company and based on knowledge of work that has been performed by the department.

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Planning Meeting with the Financial Analyst – Agenda Items

1. **Business Summary** – Discuss a summary of the business operations and lines of business of the insurer.
    a. Discuss whether the department has received a recent business plan from the company and has identified any significant changes in strategy/operations.
    b. Discuss any recent meetings with the company and their potential impact on the examination.
    c. Discuss the corporate governance in place at the company and any recent changes or concerns identified.

2. **Regulatory Actions** – Discuss any significant recent steps taken in supervising the company, including, but not limited to:
    a. Granting of permitted practices;
    b. Identification of issues of non-compliance;
    c. Follow-up on items from the last financial examination;
    d. Review of items filed with the department for approval (e.g. – Form A, Form D, Form E, etc.); and
    e. Recent or pending regulatory actions (such as forfeitures, cease & desist orders, or restrictions on the company's writings or operations).

3. **Financial Snapshot/Overview of Financial Position** – Discuss the company's recent financial results, including, but not limited to:
    a. Changes in profitability trends;
    b. Deterioration in asset quality, liquidity, or capital adequacy;
    c. Changes in investment holdings and strategy;
    d. Changes in key annual statement balances;
    e. Changes in reinsurance balances and program structure;
    f. Significant results noted in financial analysis solvency tools; and
    g. Deterioration in reserve development trends.

4. **Branded Risk Assessments** – Discuss individual branded risk assessments with a focus on moderate and significant areas of concern. For example:
    a. Discuss a summary of detailed analysis work performed to address key issues.
    b. Discuss the status of any outstanding inquiries or requests for the company.
    c. Discuss any management representations to the department that should be verified or corroborated during the exam.
    d. Discuss any recommended exam procedures and/or follow-up on key issues.
    e. Discuss any risks assessed as "minor" which appear to be escalating.

5. **Impact of Holding Company on Insurer** – Discuss the impact of the holding company system on the domestic insurer. For example:
    a. Discuss and obtain the Group Profile Summary and non-lead state holding company analysis work as necessary.
    b. Discuss whether the analyst's review of the Corporate Governance Annual Disclosure, ORSA Summary Report and/or Form F reporting indicate a need for additional follow-up and review during the exam.
    c. Discuss any developments or follow-up items resulting from recent supervisory college sessions.

6. **Overall Conclusion and Priority Rating** – Discuss the analyst's overall conclusion on the company's financial condition, strengths, weaknesses and priority rating assigned to the company.

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7. **Supervisory Plan** – Discuss the analyst's plans for the ongoing supervision of the company, including any specific examination procedures identified.

8. **Access to Workpapers and Company Documents –** Discuss the best way that the analyst's work can be reviewed/obtained. As the number of files that examiners wish to review and obtain increases, they may consider obtaining access the analyst's workpapers and receiving specific locations (i.e. workpaper references) for all requested documents.

9. **Input from Other Areas of the Department** – Discuss whether the analyst has received recent communications from other areas of the insurance department regarding issues that could impact the financial examination including, but not limited to units in charge of:
    a. Approving rates and forms filings;
    b. Legal and administrative matters; and
    c. Market conduct examinations/filings.

10. **General Observations** – Depending on the information already provided, determine whether there are any additional topics relevant for discussion, such as:
    a. If you were going onsite to examine this company, where would you focus your time?
    b. What are your biggest concerns in terms of things that could go wrong at this company to result in a solvency concern?
    c. Are you aware of any fraud allegations or concerns at the company? Are there any fraud risk factors that the exam team should be aware of?

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EXHIBIT E
AUDIT REVIEW PROCEDURES

COMPANY NAME_____
PERIOD OF EXAMINATION _____
EXAMINATION FIELD DATE _____
PREPARED BY_____
DATE_____

GUIDANCE

NAIC: Annual Financial Reporting Model Regulation (#205)
AICPA: Statement of Position (SOP) 95-4 – Letters for State Insurance Regulators to Comply with the NAIC Model Audit Rule
AICPA: Practice Alert 94-1 – Dealing with Audit Differences
AICPA: Statement on Auditing Standards (SAS) 89 – Audit Adjustments Federal Law: Sarbanes-Oxley Act of 2002 (SOX)
AICPA: AU Sec. 316 – Consideration of Fraud in a Financial Statement Audit
AICPA: Audit Risk Alert – Obtain current year alert
AICPA: SAS 104–111 – Risk Assessment Standards
AICPA: SAS 114 – The Auditor's Communication with those Charged with Governance
AICPA: Ethics Interpretation No. 501-8 – Failure to Follow Requirements of Governmental Bodies, Commissions, or Other Regulatory Agencies on Indemnification and Limitation of Liability Provisions in Connection with Audit and Other Attest Services

OVERVIEW

The intent of the risk assessment process in a risk focused examination is to identify areas of higher risk in order to enable more efficient use of examiner resources. A key to determining whether potential for material misstatement exists within the financial statements is to evaluate the insurer's audit function, which is made up of both internal and external audits.

The NAIC *Annual Financial Reporting Model Regulation* (#205) (commonly referred to as the Model Audit Rule (MAR)) was implemented in order to improve state insurance department surveillance of financial insurers by requiring an annual statutory audit of financial statements, which report the financial position and results of operations of insurers by independent certified public accountants. The primary objective of a statutory audit is to enable the external auditors to express an opinion as to whether the insurer's statutory financial statements are presented fairly in all material respects in conformity with the accounting practices prescribed or permitted by the applicable state of domicile. Effective in 2010, the MAR has additional requirements including a mandatory Attestation of Internal Control by management for insurers with premiums greater than $500 million. Portions of the MAR are referenced throughout this document.

External auditors conduct audits in accordance with Generally Accepted Auditing Standards (GAAS) for non-public companies, and the rules and auditing standards of the Public Company Accounting Oversight Board (PCAOB) for publicly traded companies. GAAS require that the audit be conducted with independence, due professional care, ethical standards, objectivity and adequate planning/supervision. The PCAOB is responsible for the development of auditing and attestation standards related to quality control, ethics and independence for publicly traded companies. When these standards are adhered to, the external auditor's opinion lends credibility to such financial statements and thereby assists in providing reasonable assurance that the insurer's financial condition is fairly presented.

Insurance companies often establish an internal audit function to assist in fulfilling such responsibilites as safeguarding assets, ensuring reliability of financial records, verifying compliance with internal procedures and assessing the efficiency of internal controls. Depending on the nature and extent of the internal auditor's work, the examiner may utilize their work to gain an understanding of the internal control structure or to assess control risk for specific identified risks.

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As the insurance industry becomes more complex in responding to technological, global and market changes, the roles of the insurance regulator and external auditor become more demanding. In many aspects, insurance regulators and auditors face similar challenges, and increasingly their roles are perceived as complementary. Insurance regulators may utilize external auditors' work to assist them with their oversight resposibilities. Likewise, the auditors, in carrying out their duties, may also look to the insurance regulators for information that may increase audit effectiveness.

The control documentation required by the audit standards provides state insurance regulators with an enhanced ability to perform a risk assessment and thus should be used to the extent feasible in performing a risk-focused examination. By leveraging off the work performed by the company's internal and external auditors, insurance regulators may be able to avoid duplication of audit and examination procedures, thereby increasing the efficiency and effectiveness of the examination. If the internal or external auditor's work is utilized, the examiner should assess and draw conclusions about the quality, adequacy and results of the auditor's work, including verification of procedures as necessary. The examiner's professional judgment should be used in determining the extent of the auditor's work to be reperformed, if any. This judgment should be based on a number of factors, including the risk associated with the testing area and the errors noted by the auditor.

The purpose of this form is to provide guidance for the review and assesssment of audit workpapers in conjunction with the state insurance department's financial examination of an insurer. This form should assist the examiner in understanding the risks identified by the external and internal auditors, how those risks were addressed, and the overall audit conclusions reached. This information may enable the examiner to conduct the risk assessment in a more effective manner. In order to fully understand the risk methodology and work performed by the external and internal auditors, the examiner should meet with the auditors prior to reviewing the workpapers to discuss the methodology regarding specific key areas, including any consideration and attestation of internal controls in accordance with SOX for publicly held companies and the Risk Assessment Standards for non-public companies. This meeting should include key engagement team members, such as the engagement partner or manager, to ensure that information is sourced from those with the most knowledge and understanding of the insurer and its financial statements.

REVIEW GUIDELINES AND INSTRUCTIONS

This form provides the examiner with a guide to facilitate the planning, performance and assessment of the internal and external auditor workpaper review, along with the review of SOX reports. This form should be completed during Phase 1, Part 3 of the risk-focused examination process.

It should be noted that not all insurers will have an internal audit department and, for those that do, the examiner should use professional judgement and consideration of the internal audit department's independence from management in the reporting structure in placing reliance on the work performed by the internal audit department. For companies where there is no segregation between management and the internal audit function, additional procedures may be required in reviewing the work performed by the internal audit department.

SARBANES-OXLEY ACT OF 2002 CONSIDERATIONS

Section 302, *Corporate Responsibility for Financial Reports,* requires principal officers to certify annual and quarterly reports. These certifications should provide information regarding the internal control structure, changes to internal controls and possible concerns on material weaknesses or significant deficiencies.

Section 404, *Management Assessment of Internal Controls,* requires annual reports to include an internal control report identifying management's responsibility for establishing and maintaining an adequate internal control structure, a management assessment on the effectiveness of the internal control structure, and an independent auditor attestation and opinion report on the assessment made by management.

If available, these documents could significantly assist the examiner in documenting and assessing the insurer's internal controls over financial reporting. Discussions with the insurer can be useful in the review of these documents in determining what information is pertinent to the examination planning objectives and what information would be most useful to the examiner.

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COOPERATION OF EXTERNAL AUDITOR

If the examiner does not receive the full cooperation of the external auditor, the examiner needs to report this occurrence to the company under examination. Examiners may be forced to duplicate audit work already performed if the external auditor does not provide the audit workpapers to the insurance regulators in a timely fashion. Insurance regulators need to be provided with applicable audit workpapers prior to on-site fieldwork, as reliance on audit work will affect the examination scope and extent of additional detail tests.

The American Institute of Certified Public Accountants (AICPA) has developed a four-step process that may be followed by regulators who are experiencing difficulty in obtaining access to external auditor workpapers, who have questions with respect to the external auditor's individual engagement to perform a statutory audit, or who have concerns about the work performed by the external auditor. The AICPA proposes that the regulator should initially follow the current process of working through the company to obtain access. To increase the chances of success in obtaining the external audit work, examiners are encouraged to notify the external auditor, with the assistance of company personnel, at least six months before the as-of date of an upcoming examination so the auditor can adjust its schedule to make the work available to the examiner earlier. Should the regulator deem that additional response is required, after informing appropriate management, the financial examiner would contact the following individuals in this suggested order, as needed:

1. The engagement partner.

2. The designated national firm representative (see the NAIC website for a listing of Big Four firm contacts).

3. Chair of the insurer's Audit Committee.

4. State Board of Accountancy, Ethics (or Qualitative Review) Committee, or other regulatory bodies deemed appropriate.

This process, excluding Step 4, is informal, non-authoritative and non-binding. This process is in addition to the remedies available to regulators. The benefits of the additive process would be to help enhance communication between regulators and independent certified public accountants, improve the effectiveness of obtaining access to audit working papers on a timely basis, and assist in strengthening the quality of statutory audits. The AICPA has communicated to practitioners the statutory requirement to provide access to audit working papers and audit-related correspondence as defined by statute.

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AUDIT REVIEW PROCEDURES

GENERAL INFORMATION: External

Accounting Firm _____

Years on Engagement _____

Date of Reports _____

Independent Accounting Firm Contacts:

NAME TITLE

_____

_____

_____

_____

GENERAL INFORMATION: Internal

Accounting Personnel _____

Years of Experience _____

Scope of Audits _____

Date of Reports _____

Internal Audit Contacts:

NAME TITLE

_____

_____

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External Auditor Workpaper and Report Review

1. Obtain the external auditor's engagement letter to ensure that there are no indemnification clauses or other unusual items included in the engagement letter.

***Guidance Point*: An indemnification clause between an insurer and an external auditor automatically breaches the independence of that auditor. If an indemnification clause exists, whether directly or indirectly, the examiner must evaluate whether it is reasonable to place reliance on the work of the external auditor. Additionally, the inclusion of an indemnification clause in a statutory auditing engagement letter is a breach of independence as outlined in the AICPA Ethics Interpretation 501-8.**

2. If not already performed by the financial analyst, obtain the following correspondence required by the NAIC *Annual Financial Reporting Model Regulation.* Evaluate the content of the correspondence for consideration in the planning phases of the examination.

   a. An "Awareness Letter" noting the external auditor's understanding of the insurance codes and regulations applicable to the insurer and affirming that the opinion expressed on the financial statements is in terms of their conformity to the statutory accounting principles.

   b. If there was a change in auditor since the last examination, obtain the following documents:

      i. A "Notification Letter" from the insurer to the commissioner stating whether, in the 24 months preceding the change in auditor, there were any disagreements with the former auditor.

      ii. A "Confirmation Letter" from the former auditor stating whether they agree with the statements contained in the insurer's "Notification Letter" and, if not, stating the reasons for which he or she does not agree.

   c. A "Qualification Letter" from the external auditor which includes the following representations:

      i. The auditor is independent.

      ii. The audit staff assigned to the engagement have sufficient background, designation and experience, in general, and the experience in audits of insurers.

      iii. The auditor's opinion will be filed in compliance with regulation.

      iv. The auditor consents to make available for review all workpapers and communications obtained as part of the audit to the examiner.

      v. The auditor is properly licensed by an appropriate state licensing authority and is a member in good standing with the AICPA.

      vi. The auditor meets the qualifications of an Independent Certified Public Accountant as defined in Section 7 of the NAIC *Annual Financial Reporting Model Regulation.*

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d. "Notification of Adverse Financial Condition," if applicable, outlining the reasons for the classification of Adverse Financial Condition.

e. "Communication of Internal Control Related Matters Noted in an Audit," which outlines any unremediated material weaknesses noted during the audit.

3. If not already performed by the financial analyst, obtain a copy of all recorded and unrecorded audit adjustments for the most recent year of the examination period (or multiple years of the examination period, if deemed necessary), along with supporting documentation regarding the adjustments or explanations from the external auditor. Evaluate the adjustments for consideration in the planning phases of the examination.

***Guidance Point*: The examiner should use information regarding audit adjustments identified by the external auditor in identifying risks or internal control weaknesses. This consideration should be documented within the examiner's workpapers.**

4. If not already performed by the financial analyst, obtain a copy of the signed management representation letter for the most recent year of the examination period (or multiple years of the examination period, if deemed necessary), which acknowledges that management is responsible for the presentation of the financial statements and has considered all uncorrected misstatements and concluded that any uncorrected misstatements are immaterial, both individually and in the aggregate. (Practice Alert 94-1: Dealing with Audit Differences; SAS 89: Audit Adjustments)

   a. Review the entire management representation letter to determine if there are any non-standard representations or representations that would have an impact on the examination.

5. If not already performed by the financial analyst, obtain a copy of the internal control-related matters presentation materials for the most recent year of the examination period (or multiple years of the examination period, if deemed necessary), including the Management Letter, prepared by the external auditor for the audit committee's review. Verify that the presentation took place through review of audit committee meeting minutes.

***Guidance Point*: The external auditor is required to provide written communication to the audit committee of all significant deficiencies or material weaknesses known by the external auditor. These comments from the external auditors should be a good guide as to what areas will need additional testwork.**

6. If not already performed by the financial analyst, obtain from the external auditor a copy of the independent statutory audit report and opinion for the most recent year of the examination period (or multiple years of the examination period, if deemed necessary).

   a. Verify that the audit report has an unmodified audit opinion, except with regard to the prescribed or permitted practices related to statutory accounting in the insurer's state of domicile. If an unmodified opinion was not issued, document the rationale for the unmodified opinion (e.g. qualified, adverse) and how this was considered during the examiner's risk assessment process.

   b. Identify any issues (material findings, contingencies, subsequent events, etc.) that should be considered during the examination. Document any issues noted and how

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they were considered during the examiner's risk assessment process.

c. Ensure that the audited financial statements reconcile to the annual statement. If not, the examiner should ask the external auditor to provide an explanation for any differences.

7. Discuss the audit with key members of the external audit engagement team. Inquire if there were any concerns with regard to the company under examination. The examiner should document any issues identified by the external auditor and consider those issues, if any, to assist in the planning phases of the examination.

Guidance Point: **This discussion should include, but not be limited to, audit scope and planning, audit methodology and audit findings. The examiner should obtain a copy of the external auditor's risk assessment if one was not provided in the workpapers. Upon request of the state insurance department conducting the regulatory examination, the audit partner in charge of the engagement should be available for potential questions regarding the audit.**

8. Obtain from the external auditor a complete copy of all relevant workpapers, including work performed at the parent or holding company level, in accordance with Section 13 of the NAIC *Annual Financial Reporting Model Regulation.*

Guidance Point: **The high-level general review of the workpapers is to assess the competency and approach of the external auditor and determine what work is available and conducted in a manner that will allow reliance by the examiner. The examiner will perform a detailed review on any workpapers related to specific control or substantive test work that may be relied upon to address specific risks identified for matrix review during Phase 3 and Phase 5.**

a. Review at a high-level the workpaper index and workpapers to identify any material financial statement accounts to determine if they were appropriately reviewed by the external auditor. Consider the impact the auditor's work will have on the identification of risks necessary for assessment by the examiner.

***Guidance Point*:** **Accounts that were not reviewed by the external auditor may correspond to the auditor's completed risk assessment and methodology. The examiner should not default to the same risk assessment as the auditor without evaluating the adequacy of the auditor's conclusions.**

b. Determine whether any workpapers will be excluded from the examiner's review and document the rationale for the exclusion.

c. If the external auditor utilized work previously completed by the internal audit department or used the internal audit staff in completing any of their planned audit procedures, obtain supporting documentation of the external auditor's use of the internal audit department. (See the "Internal Auditor Workpaper and Report Review" section for additional procedures relating to the internal audit function.)

d. Review the workpapers at a high level to identify the internal controls reviewed or tested by the external auditor. Consider whether the external auditor had reviewed different control procedures in prior year audits and obtain the relevant workpapers from prior years as appropriate.

Guidance Point: **Note that external auditors often test internal controls on a rotational basis. Therefore, it may be necessary for the examiner-in-charge to request prior year**

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workpapers from the external auditor in addition to the current year workpapers. The examiner may place reliance on testing from prior years if they are able to determine that the controls have not significantly changed.

e. Document and evaluate any discrepancies or findings noted during the high-level review of the workpapers.

9. Obtain a copy of the external auditor's documentation in relation to AU Sec. 316—*Consideration of Fraud in a Financial Statement Audit*. The AU 316 documentation should assist the examiner in completing Exhibit G – Consideration of Fraud.

Guidance Point: **The fraud risk factors identified by the external auditor in relation to AU 316 and by the examiner in Exhibit G should impact the examiner's consideration of risks inherent within the entity and impact the overall risk assessment and examination procedures completed by the examiner.**

10. Obtain copies of all legal letters obtained by the external auditor.

a. Review the legal letters to identify common themes or pending issues pertaining to insurer operations or class-action lawsuits that may impact the assessment of identified or potential risks.

b. Review the legal letters to determine the scope of further communication with legal counsel regarding litigation, claims, assessments and unasserted claims.

Guidance Point: **Risks identified within legal letters would most likely be classified as legal, reputation or operational risks.**

11. If the external auditor relied on a report on internal controls (SOC 1) provided by the insurer's service provider (data processing, claims processing, etc.), consider the adequacy of the external auditor's use and reliance of the report within their audit workpapers to facilitate the examination process.

a. Consider the documentation within the external or internal auditor's workpapers describing the consideration of any SOC reports and any assessment of risks resulting from the SOC report findings in completing the overall risk assessment.

12. Obtain and review copies of the workpapers relating to the review and assessment of the company's Information Technology (IT). If necessary, include department IT staff in the review.

Guidance Point: **The review of IT should be done in conjunction with the completion of Exhibit C – Evaluation of Controls in Information Technology.**

13. If the insurer is required to comply with SOX, obtain the following reports and determine what impact, if any, the content may have on the scope and extent of the examination:

a. Section 302, *Corporate Responsibility for Financial Reports,* which includes certification from principal officers of the annual and quarterly reports.

b. Section 404, *Management Assessment of Internal Controls,* which includes a management assessment on the effectiveness of the internal control structure and an independent auditor attestation and opinion report on the assessment made by

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	Examiner	Date
management.		

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EXHIBIT F
NOT USED IN CURRENT PERIOD

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EXHIBIT G
CONSIDERATION OF FRAUD

COMPANY NAME_____

PERIOD OF EXAMINATION _____

EXAMINER-IN-CHARGE _____

In accordance with the Risk-Focused Surveillance Framework, the consideration of fraud in financial condition examinations should occur throughout all phases of the examination. The examiner needs to consider fraud risk factors and develop examination procedures in order to adequately obtain reasonable assurance that material misstatements due to fraud are not included in the financial statements. To ensure fraud risk factors identified through the financial analysis process are considered, it is important that the exam team include a discussion of fraud in the planning meeting that takes place with the analyst. Moreover, the manner in which the insurer's management identifies, considers and mitigates the risk of fraud should factor heavily into the examiner's understanding of the company and assessment of management. The external auditors are required by AU Sec. 316—*Consideration of Fraud in a Financial Statement Audit* to perform specific procedures to ensure that the audit has been responsibly planned and performed and to obtain reasonable assurance that the financial statements are free of material misstatement. In accordance with guidance from the American Institute of Certified Public Accountants (AICPA), documentation of the auditor's consideration of fraud should be included in the external audit workpapers. The examiner should review the work performed by the auditor and consider the auditor's documentation and findings. The examiner should obtain and review this information in accordance with the review of the external audit workpapers. Although the examiner should utilize the external audit workpaper documentation to the extent deemed reasonable, reliance on the external audit workpapers does not preclude the examiner from identifying and inquiring about fraud risk factors noted during the examination or interviewing company management regarding the possibility of fraud, or known fraud occurrences.

The consideration of fraud is primarily completed through the identification and examination of fraud risk factors. Fraud risk factors are conditions that may indicate the occurrence of fraud. Some examples include the insufficient review of controls, failure to respond to known accounting irregularities, extraordinary growth or profitability, threat of regulatory action, and missing accounting documentation. This exhibit includes a detailed checklist of fraud risk factors identified in previously detected fraudulent incidences to assist the examiner in determining applicable fraud risk factors. Utilization of the Risk Assessment Matrix (Exhibit K) may be beneficial to identify and assess inherent risks, assess controls, determine residual risks and identify test procedures for applicable fraud risk factors. By properly considering and attesting to fraud risk factors, the examiner is able to obtain reasonable assurance that the financial statements are free from material misstatement due to fraud. Completion and approval of this document does not indicate that fraud has not been perpetrated on or within the company nor does it provide absolute assurance that committed frauds have been detected. It is possible to complete a properly planned and performed examination and not discover occurrences of perpetrated fraudulent activity. Additional guidance relating to fraud considerations is included in Section 1.

Note: Any examiner may complete the consideration of fraud during the examination, but the examiner-in-charge is required to review and sign-off on the prepared workpapers.

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Consideration of Fraud - Planning

Note: The following section should be completed in accordance with the consideration of fraud while planning the examination. The examiner should provide documentation of the actual review during the planning process as indicated throughout this exhibit.

PLANNING PROCEDURES	COMPLETED BY	DATE
1. Obtain and review the external audit workpapers detailing the fraud consideration documentation. Identify any fraud risk factors or other items noted, in the attached "Fraud Risk Factors" checklist below, that might be indicative of fraudulent activity by either fraudulent financial reporting, the misappropriation of assets or through fraudulent claims. (Note: If the external auditor has performed a fraud risk assessment at the holding company level rather than the insurance company entity level, the external audit workpapers may not provide enough information to warrant a thorough review as outlined in the steps below. In this instance, the examiner may choose not to rely on the external auditor's consideration of fraud and should document the rationale in the workpapers. The examiner may continue the consideration of fraud in Part B – Review Company Operations and Identify Fraud Risk Factors.)		
a. Document any fraud risk factors noted and procedures performed by the external auditor to mitigate fraud risk.		
b. Document the results of communications amongst the external auditors, company officials or others with respect to the risk of fraud in the entity and known fraudulent activity perpetrated by or within the company.		
c. Review and evaluate the other information documented by the external auditor with respect to their consideration of fraud and utilize this information, if applicable, to develop and further enhance the planned examination procedures.		
2. Review the company's operations, both financial and non-financial, to identify any additional fraud risk factors. Consider input provided by the financial analyst during the examination planning meeting. Review and adjust the planned examination procedures according to the noted risk factors. Use the external audit workpapers to facilitate this review.		
a. Document the fraud risk factors identified and the examination procedures designed to mitigate the fraud risk. (Note: These procedures typically entail inquiring of management and others about the risk or occurrence of fraud, performing an evaluation of analytical procedures, considering fraud risk factors, and considering other information deemed pertinent for the determination of fraud.)		
b. Summarize the auditor's consideration of management's ability to override controls. Evaluate and document the auditor's determination to perform (or not perform) additional procedures to address the risk of control deviations due to management overrides.		

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PLANNING PROCEDURES	COMPLETED BY	DATE
c. Document other risks or conditions noted by the auditor that resulted in the auditor completing additional auditing procedures or documenting added responses.		
d. Document any communications the external auditor had regarding fraud, or the risk of fraud, with the company's management, audit committee, or other individuals. The examiner should consider the level of management informed for all known fraudulent acts.		
e. For those fraud risk factors identified, document the examination procedures or steps the examiner will perform to mitigate fraud risk.		
3. Meet with company management to discuss the risk of material misstatement due to fraud in the entity and to inquire whether management is aware of any fraudulent activity that has been conducted on or within the company and if the company is maintaining compliance with federal anti-money laundering requirements. Determine that the company has established antifraud initiatives reasonably calculated to detect, prosecute and prevent fraudulent insurance acts.		
a. Identify the company managers utilized for this discussion and summarize the dialogue results. Include the discussion results in a memorandum for inclusion in the workpapers.		

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Consideration of Fraud - Testing

Note: The following section should be completed in accordance with the consideration of fraud during testing of the examination. The examiner should provide documentation of the actual review during testing as indicated throughout this exhibit.

TESTING PROCEDURES	COMPLETED BY	DATE
1. Continue to identify fraud risk factors during the examination process. Adapt the planned examination procedures as necessary to mitigate fraud risk.		
a. Review the planned examination approach to determine if modification is necessary, in accordance with the additional identified fraud risk factors.		
b. Evaluate the assessed materiality levels as well as the overall risk assessment, to adequately reflect the discovery of additional fraud risk factors.		
c. Document any changes to the planned examination approach, materiality levels or the overall risk assessments in a memorandum for inclusion in the examination workpapers.		
2. Review the fraud initiatives established by the company to advertise, identify, investigate and report fraudulent acts.		
a. Verify that the established fraud program is advertised and promoted to the company's insureds.		
i. Determine whether claim forms and applications indicate that any person who knowingly presents a false or fraudulent claim for payment of a loss or benefit or knowingly presents false information in an application for insurance is guilty of a crime and may be subject to fines and confinement in prison.		
b. Verify that the company has established a procedure to report fraudulent insurance acts to the insurance commissioner in the manner prescribed by the commissioner.		
3. If applicable, based on the offering of covered products, obtain and verify that the company has established and maintains a written anti-money laundering program that has been approved by senior management and contains the following elements: (i) internal controls based upon the company's risk assessment (that should also cover the brokers and agents used by the company), which are designed to detect and deter money laundering, terrorist financing and other financial crimes associated with the covered products; (ii) the appointment of an anti-money laundering compliance officer including details on the role he/she will play in the day-to-day supervision of the company; (iii) a documented anti-money laundering training program for appropriate personnel and agents; and (iv) documented policies and procedures to perform independent testing on a periodic basis to measure compliance. If the examiner determines that the company has not established, or is not maintaining, such an anti-money		

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TESTING PROCEDURES	COMPLETED BY	DATE
laundering program, the Financial Crimes Enforcement Network should be notified accordingly. See detail guidance regarding anti-money laundering programs in Section 1.		
a. Obtain copies of the company's risk assessment and independent test plans and review for reasonableness. Review the results of testing performed including any significant issues. If significant issues related to anti-money laundering are identified, the examiner should notify the appropriate federal agency as explained in Section 1, Part IV.		
b. Verify that the company is taking active measures to address all significant deficiencies noted in the independent testing results.		
4. Document the investigation of any potential fraudulent activity noted during the examination process. *(Note: This does not refer to additional fraud risk factors identified.)*		
a. If, after completing the review of fraud risk factors and examination procedures, the examiner identifies a potential fraud situation, the examiner and examiner-in-charge, depending on state guidelines, should either inform the appropriate state insurance department division responsible for investigating potential fraudulent activity, or perform procedures to further investigate the potential fraudulent activity. If the examiner is investigating the potential fraud, the examiner should:		
i. Discuss the nature and effect of the fraudulent activity with the appropriate level of management.		
ii. Attempt to obtain additional evidential matter regarding the fraudulent activity to determine the overall effect on the financial statements and the company operations.		
b. Verify that necessary information regarding the knowledge or reasonable belief that a fraudulent act has been, will be, or is being committed has been communicated to the insurance commissioner as required. (Note: If the state has adopted the NAIC Insurance Fraud Prevention Model Act (#680), information obtained by the commissioner in an investigation of a suspected or known fraudulent act is confidential by law and is not subject to subpoena. In addition, the commissioner, or individual gathering the information on behalf of the commissioner, is not permitted or required to testify in a private civil action regarding the confidential documents.)		

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CONSIDERATION OF FRAUD - WRAP-UP

Note: The following section should be completed in accordance with the consideration of fraud during the completion of the examination. The examiner should provide documentation of the actual review during the wrap-up procedures as indicated throughout this exhibit.

WRAP-UP PROCEDURES	COMPLETED BY	DATE
1. Review the fraud risk factors identified throughout the examination and the examination procedures completed to verify that the noted fraud risk factors have been adequately considered throughout the examination process.		
2. Although the focus of the examination is not to detect fraud, verify that the examination has been conducted in a manner to alleviate the risk of fraud through the consideration of fraud risk factors.		
3. Verify that the report of examination properly presents the financial condition of the company with regard to any known instances of fraud perpetrated on or within the company.		

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Review Company Operations and Identify Fraud Risk Factors

Review the company's operations, both financial and non-financial, to identify fraud risk factors. Common fraud risk factors are indicated in the following chart. The fraud risk factors are categorized according to the three conditions typically present when fraud occurs:

- Incentives/pressures to commit fraud.

- Opportunities exist to perpetrate fraud.

- Attitudes/rationalizations that fraud is ethical or acceptable.

For risk factors that are applicable to the insurer under examination provide relevant information regarding that risk in the comments section.

FRAUD RISK FACTORS	COMPANY APPLICABILITY			
	Y	N	N/A	COMMENTS
Misstatements from Fraudulent Financial Reporting				
Incentives / Pressures				
1. Are any of the following conditions present that may indicate a personal incentive for management to engage in fraudulent financial reporting?				
a. Are compensatory management bonuses and incentives derived from the company's ability to accomplish aggressive operating or performance results?				
b. Do any other conditions exist that may indicate a motivation for management to engage in fraudulent financial reporting?				
c. Are unduly aggressive financial targets and expectations for operating personnel established by management?				
d. Is management or the board of directors' personal financial situation threatened by the individual's financial interests in the entity?				
2. Is the financial stability or profitability of the company threatened by economic, industry or entity operating conditions?				
a. Is the company subject to new accounting, statutory or regulatory pronouncements that could hinder the company's profitability or financial stability?				
b. Is the company encountering significant competition or market saturation and declining margins?				
Is the insurance industry experiencing an increase in the number of insolvencies?				
d. Is the industry experiencing rapid changes in technology?				

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FRAUD RISK FACTORS	COMPANY APPLICABILITY			
	Y	N	N/A	COMMENTS
e. Is the holding company's ability to meet its debt service requirements contingent upon increased profits and/or dividends from the insurance subsidiaries?				
f. Has the company experienced unusually rapid growth or profitability when compared with other companies in the same industry?				
3. Does company management have substantial pressure to acquire additional operating capital?				
4. Is management subject to excessive pressure to meet expectations or requirements of third parties?				
a. Is the company highly vulnerable to changes in interest rates?				
b. Does the company need to obtain debt financing or does the company have a marginal ability to meet debt repayment requirements? Are the debt covenants difficult to maintain?				
c. Could the company face adverse consequences on a significant pending transaction (such as a business combination, financing arrangement or contract award) if poor financial results are reported?				
5. Has the company set unrealistically aggressive sales or profitability incentive programs?				
6. Is the company facing the threat of insolvency?				
Opportunities				
1. Do the company's operations provide opportunities to engage in fraudulent activity?				
a. Does the company engage in significant related-party transactions that are not considered to be in the ordinary course of business, or with companies not subject to the examination process or audited by an independent accounting firm?				
b. Are the company's financial statements subject to significant estimates that were determined by subjective judgments or uncertainties, or that can adversely impact the financials if changed?				
Does the company have unusual or highly complex transactions (particularly those close to year-end) that are difficult to assess for substance over form?				

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FRAUD RISK FACTORS	COMPANY APPLICABILITY			
	Y	N	N/A	COMMENTS
d. Does the company have significant bank accounts or subsidiary or branch operations in tax-haven jurisdictions for which there appears to be no clear business justification?				
2. Does the company lack appropriate monitoring controls over management?				
a. Is the overall management of the company dominated by a single person or small group without compensating controls (i.e., appropriate oversight by the board of directors or audit committee)?				
b. Does the board of directors lack active involvement in the oversight of the financial reporting process and internal control?				
3. Does the company have a complex or unstable organizational structure?				
a. Is it difficult to determine the organization or individual(s) that control(s) the entity?				
b. Does the company have an overly complex organizational structure involving numerous or unusual legal entities or managerial lines of authority?				
c. Is there a high turnover within senior management, the audit committee, board members or legal counsel?				
4. Does the company have insuffient internal controls or are internal controls operating improperly?				
a. Has the company been observed to employ an ineffective accounting, internal auditing or information technology staff?				
b. Is there a high turnover rate in accounting, internal audit or information technology staff?				
Attitudes				
1. Does company management convey an improper attitude regarding internal controls and the financial reporting process?				
a. Does management neglect to effectively communicate and encourage the company's values or ethics?				
b. Does management have an excessive interest in preserving or increasing the earning's trend through the use of aggressive accounting practices?				
c. Does management have an interest in engaging inappropriate methods to diminish reported earnings on a tax-motivated				

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FRAUD RISK FACTORS	COMPANY APPLICABILITY			
	Y	N	N/A	COMMENTS
basis?				
d. Are there instances of management failing to correct known reportable conditions within an appropriate time frame?				
e. Does management illustrate a substantial disregard for regulatory authorities?				
2. Are management and employees employed in a non-financial department utilized to determine the accounting practices and financial estimates?				
3. Do related or competing businesses consider the management to have a poor reputation?				
4. Have any of the following situations occurred illustrating a strained relationship with either the current or predecessor auditor?				
a. Are there frequent disputes regarding accounting, auditing or reporting matters?				
b. Is the auditor limited to specific individuals or sources of information while conducting the audit?				
c. Are auditor communications with the board of directors or the audit committee restricted?				
d. Does management attempt to influence the auditor and/or the scope of the auditor's work?				
5. Are there any instances of fraud claims against the company or management or any recognized violations of security laws?				
Misstatements from Misappropriation of Assets				
Incentives/Pressures				
1. Are personal financial obligations of management or employees with access to cash and other assets creating pressure to misappropriate assets?				
2. Do adverse relationships exist between the company and employees (e.g., anticipated lay-offs, compensation issues) that may motivate an employee to misappropriate assets?				
Opportunities				
1. Does the company maintain or process large amounts of cash?				
2. Does the company have fixed assets that are easily susceptible to misappropriation (e.g., small size, portability, marketability, lack				

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FRAUD RISK FACTORS	COMPANY APPLICABILITY			
	Y	N	N/A	COMMENTS
of ownership identification, etc.)?				
3. Is the company susceptible to fraudulent, unauthorized disbursements (e.g., claim payments or payroll disbursements) being made in amounts that are material to the financial statements?				
4. Do any of the conditions listed below, that may indicate possible deficiencies in the company's internal controls over assets susceptible to misappropriation, exist?				
a. Is there a lack of appropriate management oversight of assets that are susceptible for misappropriation (e.g., inadequate supervision or monitoring of remote locations)?				
b. Is there inadequate record-keeping with respect to assets susceptible to misappropriation?				
c. Is there a lack of appropriate segregation of duties or independent checks not mitigated by other factors?				
d. Does the company lack an appropriate system of authorization and approval of transactions (e.g. [illegible] loss payments)?				
e. Are there inadequate physical safeguards [illegible] investments, inventory, or fixed assets?				
f. Is there a lack of timely and appropriate documentation for transactions affecting assets susceptible to misappropriation (e.g., rejected claims, benefit payments, etc.)?				
g. Has the company failed to require mandatory vacations for employees in key control functions?				
h. Does management have an inadequate understanding of information technology, which could enable IT employees to misappropriate assets?				
i. Are access controls over automated records, including control over and review of computer systems event logs, inadequate?				
Attitudes / Rationalizations				
1. Does management display a disregard for internal controls by [illegible] controls or failing to correct control deficiencies?				
2. Is there disregard for the need to monitor and reduce risks relating to the misappropriation of assets?				
3. Has there been any behavioral or lifestyle changes for management or employees that may indicate that assets have been				

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FRAUD RISK FACTORS	COMPANY APPLICABILITY			
	Y	N	N/A	COMMENTS
misappropriated?				
4. Has there been behavior indicating displeasure or dissatisfaction with the company or its treatment of employees?				
Fraudulent Claims				
Note: The following risk factors indicate possible warning signs for fraudulent claims. Although the examiner should not evaluate all submitted claims for fraud, the examiner should verify that the company has established control procedures to mitigate related risk factors. If the company has experienced a significant number of fraudulent claims, the examiner should perform additional procedures to determine the company's actions to prevent and detect fraudulent claims.				
1. Does the company have several claims within the first six months of a coverage period or during the policy's contestable period?				
2. Does the company typically accept photocopied claim forms?				
3. Does the company usually write insurance policies with excess coverage limits for the type of risk insured?				
4. Does the company fail to adequately review submitted claims and, therefore, inadvertently process claims with the following characteristics?				
a. Write-outs, type-overs, and erasures.				
b. Misspelled medical terms, and terms inconsistent with the diagnosis or treatment.				
c. Suspiciously detailed or extremely vague information concerning the claim.				
d. Stamped or photocopied physician/lawyer approval.				
e. Claimant address is a post office box.				
f. Subjective diagnosis or general statement of diagnosis rather than actual records.				
g. Omitted or different personal information on the claim form.				
h. Claim indicates physicians, attorneys, or employers who are outside the claimant's geographical area, or who have been included on other questionable claims.				

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EXHIBIT H
INSURER PROFILE SUMMARY TEMPLATE

Introductory Guidance

An Insurer Profile Summary (IPS) should be developed by the domestic state for each domestic insurer. The Insurer Profile Summary should be updated each year through the annual financial statement analysis process, updated after the conclusion of on-site examination activities at the insurer (full-scope or limited scope) and updated as significant information impacting the insurer is identified throughout the year. The Insurer Profile Summary is intended to provide a high-level overview of the current and prospective solvency of the insurer as well as the ongoing regulatory plan to ensure effective supervision. A separate Supervisory Plan may also be utilized to outline steps to ensure effective supervision for high-priority or potentially troubled insurers.

The Insurer Profile Summary should be concise and should contain information related to each of the five elements of the regulatory Risk-Focused Surveillance Cycle:

- Financial Analysis
- Financial Examination
- Internal/External Changes
- Priority System
- Supervisory Plan

In addition, the Insurer Profile Summary should provide an assessment of the insurer's prospective exposure to each of the nine branded risk classifications. This assessment is intended to foster improved communication regarding risk exposures between functions (e.g., financial analysis, financial exam, etc.) and across states.

A template that can be used in developing an Insurer Profile Summary, including example company information, is provided below; however, the actual form and content should be determined by each respective state as the only required elements of an Insurer Profile Summary are those listed above. In addition, each state should determine how it will allocate its resources to create and maintain the Insurer Profile Summary. Regardless of who creates and maintains the document, a current version should be available for review and use by assigned financial analysts and financial examiners as well as individuals from other relevant internal departments with a need to access the information (e.g., licensing, rates and forms, legal) upon request. In addition, the Insurer Profile Summary should be made available to other relevant states, upon written request, in accordance with the "Insurer Profile Summary Sharing Best Practices Guide" posted on I-Site+.

Note: The Insurer Profile Summary is a key document that the exam team reviews during planning. Therefore, the examiner responsible for leading the planning meeting with the analyst should be prepared to inquire on matters discussed within the Insurer Profile Summary as part of their meeting with the financial analyst who prepared the IPS.

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XX DEPARTMENT OF INSURANCE
INSURER PROFILE SUMMARY
COMPANY NAME
As of 12/31/20XX
Updated as of XX/XX/20XX

Insurer's Group Number
List here

Lead State/Groupwide Supervisor
List here

State Prioritization
List X out of X

RBC
List percentage here as calculated in the five-year history by the Company

Insurer's Financial Strength/Credit Ratings
List here

Analyst Team Designation
List here

Contact at Insurer
List name here
List phone here
List email here

Key Personnel
List name here – CEO
List name here – CFO
List name here – CRO
List name here – Other

CPA Firm
List here

Appointed Actuary
List here

Analyst
List here

Date of Last Exam
List here

Examiner-In-Charge
List here

BUSINESS SUMMARY

Provide a summary of the business operations and lines of business of the insurer.

ABC is an independently owned property and casualty insurance organization based in state X that specializes primarily in writing private passenger automobile insurance coverage. Through its subsidiaries—DEF Insurance Company, GHI Insurance Company, JKL Underwriters and MNO Premium Finance Company—the group offers a variety of insurance related services, including premium finance and claims processing.

REGULATORY ACTIONS

Discuss any significant actions taken against the company, permitted practices, issues of non-compliance, results from the most recent financial examination, etc.

In 20XX, ABC was required to file a corrective action plan with the department to address its breach of the RBC company action level. Since that time, ABC received a capital infusion from its parent and has raised its RBC to an acceptable level. The company has been granted a permitted practice relating to its SCA investment in JKL Underwriters. The permitted practice allows ABC to admit its investment in JKL ($2 million at 12/31/XX) without requiring an independent financial statement audit.

FINANCIAL SNAPSHOT (SUMMARY DATA) – OPTIONAL

Assets and Liabilities

Years Ended December 31 (Dollars in millions)	20XX	20XX
Total Invested Assets	219	253
Other Assets	111	131
TOTAL ASSETS	330	384
LIABILITIES		
Insurance Reserves	97	95
Other Liabilities	169	193
TOTAL LIABILITIES	266	288
Capital and Surplus	64	96
TOTAL LIABILITIES AND C&S	330	384

Operations	20XX	20XX
Premiums	218	233
Investment income (net of gains/losses)	1	8
Other income	0	0
Total revenues	219	241
LOSSES, BENEFITS AND EXPENSES		
Policyholder Benefits	177	157
Expenses	77	80
Total losses, benefits and expenses	254	237
Other	0	2
NET INCOME	(35)	2

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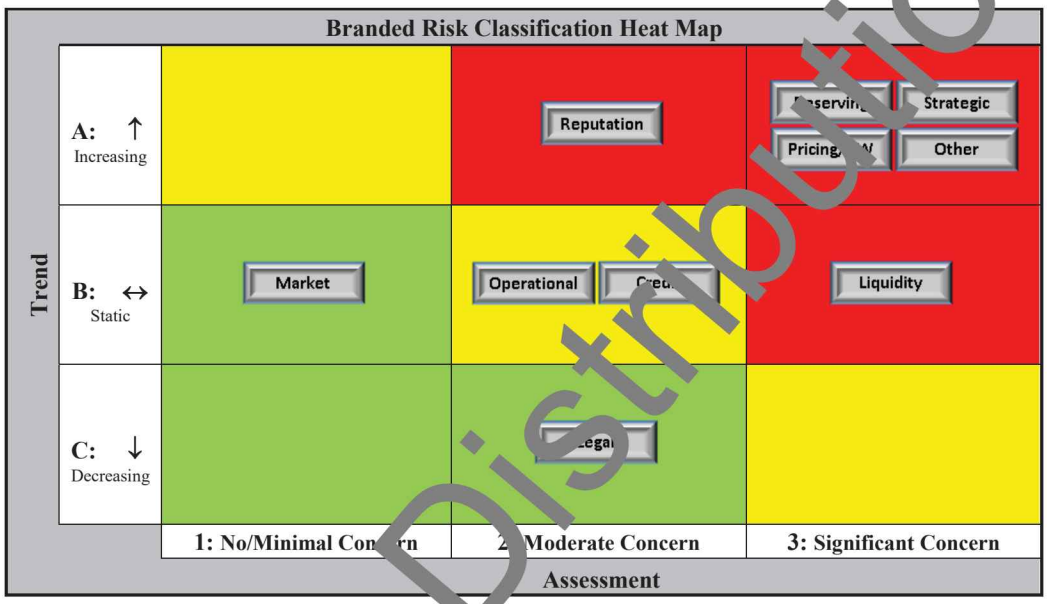
BRANDED RISK ASSESSMENTS

Summarize your assessment of the branded risk classifications for the insurer based upon both quantitative (e.g., five-year trending of key ratios) and qualitative information. An assessment of each significant individual risk component (including prospective risks) relevant to the classification should be provided by indicating either "no/minimal concern," "moderate concern" or "significant concern," as well as the direction in which the risk is trending. If no significant individual risk components are identified for a branded risk classification, documentation should be provided to support this conclusion. Consider the materiality and/or significance of each individual risk component in aggregating the overall assessment and overall trend for each branded risk classification. Update the Branded Risk Classification Heat Map to illustrate your conclusions.



Credit: This risk is considered moderate, driven primarily by a fairly conservative investment mix (96.4% of bonds are NAIC 1 with 28% U.S. government, 14% U.S. states, most of the rest high-quality corporates) and limited exposure to equities, offset by a relatively high amount of real estate ($33 million), growing agent balances ($99 million) and significant reinsurance recoverables (paid and unpaid) of $8[illegible] million. However, the reinsurance recoverables are diversified across a number of highly rated reinsurers.

No/Minimal Concern	Moderate Concern	Significant Concern	Trend
Bonds			↔
Reinsurance Recoverable			↑
	Real Estate-Home Office		↔
		Agent Balances & Uncoll Premiums	↑
Overall Credit Assessment: Moderate Concern		**Overall Trend: ↔**	

Legal: The Company has a vested interest in the outcome of the case of *GEI v. Virtual Imaging*, which is before the State Supreme Court. This case pertains to a change in statutes, effective January 1, 2008, that affected the manner in which insurers, including the Company, have paid claims. Subsequent to the statutory change, cases have been brought and trial courts have concurred that the statutes and resulting payments are ambiguities in the statutes. These cases are collectively known as the "Fee Schedule" matter. The Company began receiving lawsuits on this matter in May 2010, some of which were closed at high cost. Since that time, the Company has modified its strategy for handling these cases and has received multiple trial victories from juries that ruled no further payments were owed to the plaintiffs. Exam results indicate that the Company's legal team tracks and monitors outstanding lawsuits and involves experienced external counsel in representing the Company in these matters.

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No/Minimal Concern	Moderate Concern	Significant Concern	Trend
Effectiveness of legal counsel			↔
	Fee Schedule lawsuits		↓
Overall Legal Assessment: Moderate Concern		**Overall Trend: ↓**	

Liquidity: The Company is subject to high liquidity risk due to the lines of business written and the corresponding need to meet short-term obligations. The Company's high exposure to the volatile PIP market and related losses has reversed the trend of improved liquidity in recent years. Trends in the Company's five-year liquidity ratio are shown in the following chart, which was indicating improvements before a negative shift in the current year:

	CY	PY	PY1	PY2	PY3
Liquidity Ratio	108.5%	98.3%	101.4%	107.1%	113.0%

No/Minimal Concern	Moderate Concern	Significant Concern	Trend
		Exposure to PIP Market	↔
		Liquidity Ratio	↔
Overall Liquidity Assessment: Significant Concern		**Overall Trend: ↔**	

Market: Market risk includes equity risks, changes in credit spreads, and also interest rate risks. Most of these risks are not inherently significant to the Company due to its relatively conservative investment portfolio and relatively short-term policies (typically six months or one year), which allow the Company to reprice fairly easily to align with shifts in the market. However, as shown during the financial crisis, some of the Company's products are more sensitive to general economic downturns, which can impact the Company's performance.

No/Minimal Concern	Moderate Concern	Significant Concern	Trend
Equity			↔
Changes in Credit Spreads			↔
	Economic Downturn		↔
Overall Market Assessment: Minimal Concern		**Overall Trend: ↔**	

Operational: The results of the last exam indicated that the Company has a reliable IT environment and effective internal controls in most areas. However, concerns were raised regarding segregation of duty issues relating to the handling of claims and cash disbursements during the last exam. In addition, a recent news report indicated that one of the Company's independent agents has been charged with committing fraudulent activities. Due to the Company's heavy reliance on independent agents to generate business and manage policyholder relations, even though the report might be an isolated incident it represents a moderate concern in this category.

No/Minimal Concern	Moderate Concern	Significant Concern	Trend
IT Environment			↔
	Segregation of Duties		↔
	Agent Fraud		↑
Overall Operational Assessment: Moderate Concern		**Overall Trend: ↔**	

Pricing/Underwriting: Although the Company is primarily engaged in short-term products (six months or one year), it is subject to highly competitive price pressure and has shown historically weak underwriting results. Underwriting results have shown a negative trend over the past six periods as losses incurred continue to rise, a sign that pricing pressures are influencing the bottom line. The Company appears to be utilizing cash flow underwriting as a way to bolster earnings through investment income, which leads to a concern regarding the adequacy/appropriateness of rates used by the Company. In addition, the last financial exam noted a lack of documented underwriting guidelines at the Company, which is in the process of being corrected. However, the lack of documented, detailed underwriting guidelines represents a moderate concern in this area. Overall, this risk category represents a significant ongoing concern for the Company.

No/Minimal Concern	Moderate Concern	Significant Concern	Trend
	Underwriting Guidelines		↔
		Rate Adequacy	↑
Overall Pricing/Underwriting Assessment: Significant Concern		**Overall Trend: ↑**	

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Reputation: The Company's business is not rating sensitive, but the Company is highly dependent upon business produced by agents. As noted above, a recent concern has been identified regarding potential fraud committed by one of the Company's agents. In addition, findings of a recent market conduct examination lead to numerous violations. These violations related to claims handling issues, such as failure to comply with timely payments and denial of legitimate claims. Although the Company has disputed these findings, gross writings continue to suffer as several agents have stopped writing on behalf of the Company.

No/Minimal Concern	Moderate Concern	Significant Concern	Trend
	Agent Fraud		↑
	Market Conduct Findings		↑
Overall Reputation Assessment: Moderate Concern		**Overall Trend: ↑**	

Reserving: The Company is subject to high reserving risk, as shown in the following reserve trending information. The Company historically has been overly optimistic in the forecasting of future liabilities and reserving, which actual reported results have failed to meet projections. The types of business written and geographic regions in which coverage is provided leave the Company vulnerable to high losses and a greater than industry average risk for adverse reserve development.

	CY	PY	PY1	PY2	PY3
Two Year Develop	53.4%	8.0%	-20.3%	25.7%	100.1%
Loss & LAE/C&S	204.1%	132.3%	168.0%	235.2%	496.9%

No/Minimal Concern	Moderate Concern	Significant Concern	Trend
		Lines of Business	↔
		Loss Development	↑
Overall Reserving Assessment: Significant Concern		**Overall Trend: ↑**	

Strategic: The following issues have been identified relating to the Company's strategy:

- As discussed above, the Company has experienced weak underwriting, which has resulted in material losses and material reductions in capital. Underwriting losses have been reported in each of the past five years. Consequently, profitability and capital are considered weak as investment activity has been used to prop-up the bottom line, in addition to capital contributions from the Company's parent. The Company has not yet finalized and presented an updated business plan to demonstrate how it will address these strategic issues going forward.
- The Company indicated in its Form F that it was changing its mix of business in states other than State X and Y. This could create a risk as the Company has only been writing in the other states for a few years; therefore, there is limited historical development available for these states. This should be considered in the context of the targeted examination.

No/Minimal Concern	Moderate Concern	Significant Concern	Trend
	Expansion in new jurisdictions		↑
		Profitability/capital concerns	↑
Overall Strategic Assessment: Significant Concern		**Overall Trend: ↑**	

Other: The following other issues have been identified that don't clearly fit into one of the branded risk classifications highlighted above:

- The company has consistently been out of compliance with one or more laws, regulations or requirements of the Department and other states.

No/Minimal Concern	Moderate Concern	Significant Concern	Trend
	Incorrect statutory financial statements		↑
		Lack of knowledge or laws	↑
Overall Strategic Assessment: Significant Concern		**Overall Trend: ↑**	

IMPACT OF HOLDING COMPANY ON INSURER

Summarize the evaluation of the impact of the holding company system on the domestic insurer.

The group is highly dependent upon cash flows from the various entities, including ABC, to make payments on the holding company debt used to help finance past transactions associated with the growth of the group. The Form F

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provides more specific information on necessary cash flows expected in the near term. Others risk from the non-insurers is not significant. See non-lead state holding company analysis for further discussion.

OVERALL CONCLUSION AND PRIORITY RATING

This section should include an overall conclusion as to the Company's financial condition, discuss strengths that potentially mitigate the risks assessed above, and highlight any concerns with the Company's operations going forward. Include any actions that may have been taken (e.g., significant holding company transactions, prior or planned meetings with management, and referrals to/from other divisions, etc.). Recommend the priority that should be assigned to the Company and explain the rationale.

Based on the branded risk assessments provided above as well as the Company's poor financial results reported in recent periods, the Company appears to be potentially troubled. The Company has triggered more than five of the department's prioritization criteria and is a multi-state insurer; therefore, the Company has been assigned our highest priority rating of 1, which is unchanged from the prior year. Some of the most significant issues facing the Company include rate adequacy, reserve sufficiency and overall cash flow and liquidity issues. However, these weaknesses are somewhat offset by Company strengths including a conservative investment portfolio, brand recognition and a strong historical reputation. The department has scheduled a meeting with senior management for the third quarter to discuss the Company's poor financial performance and ongoing business plan. During the meeting, the department plans to share its concerns and inform the Company of steps planned to more closely monitor the company's operations as described below.

SUPERVISORY PLAN

List any specifically identified items that require further monitoring by the analyst or specific testing by the examiner. In addition, indicate if the Company is or should be subject to any enhanced monitoring, such as monthly reporting, a targeted examination or a more frequent exam cycle.

Analysis Follow-Up

- Obtain further detail regarding the impact of proposed rate increases and monitor through monthly financial reporting
- Obtain further detail regarding the insurer liquidity strategy.
- Assess the reasonableness of the Company's business plan as soon as it is received, given the inability to execute the most recent strategy. Consider attending board meetings to reflect the concern regarding the future viability of the Company.

Examination Follow-Up

- During the next regularly scheduled examination, audit the specific risks associated with the Company's agents balances and uncollected premiums and determine if further concerns exist.
- Follow-up on segregation of duties issues noted in the last examination.
- Perform a targeted examination of the reserves, pricing and claims management. Consider in the reserve study any pricing review, information related to the changing legal environment as well as the mix of business in states outside of X and Y.

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EXHIBIT I
EXAMINATION PLANNING MEMORANDUM

The following is an illustration of an examination planning memorandum to assist examiners in documenting the results of the planning process at the conclusion of Phase 2. This exhibit is not intended to be all-inclusive and should be tailored to each examination. It is not necessary for every examination's planning memorandum to address each of the areas and points discussed herein. Therefore, the examiner-in-charge should use his or her judgment in determining which sections of this illustration are applicable and document any other pertinent information considered. In making these judgments, the examiner should bear in mind the purpose of the planning memorandum, which is to provide a concise summary of examination risks, significant examination activities and the overall examination approach. Where feasible, the planning memorandum should reference key documents, detail reports and information through attachment. Some items that may be attached to the planning memorandum are the preliminary analytical review, annual statement jurat page, Schedule Y and FEETS Premium Schedule.

COMPANY NAME:

EXAMINATION DATE:

This planning memorandum is intended to document our examination plan as it relates to (Name of Insurance Company) for the period from January 1, 20XX to December 31, 20XX.

SCOPE AND OBJECTIVES OF THE EXAMINATION

Scope

The examiner should describe the scope of the exam, including whether the examination was conducted in accordance with the NAIC *Financial Condition Examiners Handbook* and [State] statutes and regulations. This section should also explain whether any affiliates or subsidiaries were examined in correlation with this examination and document any other states involved with these exams. The use of specialists can be noted here at a high level, as there is a separate section for this later in the exam planning memo. The timing of updates with other department personnel can be described here. This documentation is especially important if contract examiners are utilized for the examination. The exam team should also document the plan to conduct specific procedures that may fall outside the scope of a typical risk-focused financial examination, including procedures related to compliance testing or market conduct issues that may be addressed.

Examination Goals and Objectives

The department may consider establishing specific or general goals for the examination. The following are examples of general examination goals and objectives of a risk-focused examination approach:

- Perform an examination utilizing business risk assessment activities, focusing examination procedures on those areas considered to have greater risk in order to identify significant operating issues and/or deviations from Statutory Accounting Practices that affect solvency assessment.
- Identify significant deviations from state insurance laws, regulations and department directives.
- Conduct the examination in accordance with standards prescribed in the *Financial Condition Examiners Handbook*, NAIC Accreditation Standards and department policy.
- Identify and report on significant operational and internal control deficiencies.
- Assess the company's governance structure, corporate culture and management processes in order to assess management's (includes Board of Directors) ability to identify, evaluate and control its business risks.
- Identify and report any prospective risks for continued monitoring and surveillance by the department.
- Complete the examination efficiently within the budgeted time and within scheduling requirements.
- Provide on-the-job training and professional development of department staff..

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COORDINATION ACTIVITIES

This section documents relevant correspondence with insurance regulators from other states. The examiner should document whether the examination was called, in accordance with the *Handbook* guidelines, through the NAIC's Financial Exam Electronic Tracking System (FEETS), invited state(s), correspondence from such state(s) and/or participating examiners, and to what extent representative(s) from other state(s) will be involved in planning the examination and developing the scope of procedures. This section may refer to a completed Exhibit Z – Examination Coordination document for additional discussion on this topic.

COMPANY BACKGROUND (Phase 1, Part 1, Steps 1-2)

The examiner should briefly document significant operating characteristics of the company, including the type of company (e.g., Mutual, Stock, Title, HMO, Captive), capital structure, ownership, state(s) of licensure and the as-of date of the last financial condition and market conduct examinations. A summary of regulatory activities since the prior examination, including market conduct and/or limited-scope examinations, should also be included, if applicable.

Lines of Business / Operations

This section should describe the general operations of the company, including a summary of business strategies, competitive challenges, key business lines, product mix, marketing emphasis, primary distribution channels, growth areas, acquisition or divestiture plans and new products or distribution channels since the prior examination.

Reinsurance

Summarize the company's overall reinsurance strategy and significant reinsurance contracts in place to protect against losses.

Subsidiaries and Affiliated Companies

The examiner should include a brief description of the organization's structure, including legal and business units, any structural changes since the prior review, and location(s) of the operational units (accounting, claims, investments, etc.). The examiner may find it beneficial to also provide an organizational chart.

RELATED PARTY TRANSACTIONS

Related parties are defined as entities that have common interests as a result of ownership, control, affiliation or by contract. Related parties should be given consideration under the risk-focused surveillance process, as related party transactions are subject to abuse because reporting entities may be induced to enter transactions that may not reflect economic realities or may not be fair and reasonable to the reporting entity or its policyholders. The examiner should describe significant agreements/transactions (e.g., pooling agreements, reinsurance contracts, intercompany management and service arrangements, tax-sharing agreements, etc.) and/or findings with any of the following:

- Parent, affiliates, subsidiaries and ultimate controlling person.
- Principal owners.
- Controlling shareholders (10% and greater).
- Board of Directors and officers,
- Any other entities meeting the related party definition.

DEPARTMENTAL (INTERNAL) MEETINGS (Phase 1, Part 1, Steps 1-2)

Summarize what the examination team has done to coordinate with inter-department personnel, such as meetings with the chief examiner, financial analyst or department actuary, and discussions with or inquiries of other sections of the department, such as market conduct, licensing, or rates/forms. Discuss the priority scoring system and how domestic regulator and other state insurance regulators used this information to establish the level and areas of concern with respect to the insurer's operations and to develop and/or update the insurer profile summary and supervisory plan for the next 12 to 18 months.

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MEETINGS WITH OTHER REGULATORS (Phase 1, Part 1, Steps 1-2)

Summarize any meetings held with other state, federal and international regulators that are outside the state insurance regulatory structure. These meetings should discuss regulatory concerns that may be addressed during the examination.

EXTERNAL ENVIRONMENTAL CONSIDERATIONS

The risk-focused surveillance process calls for the examiner to consider both internal and external factors when developing the examination approach for the insurer. In this section, the examiner should identify external environmental factors or conditions pertinent to the company's operations, investments and/or line(s) of business. The following are examples of such factors or conditions that could affect or influence an examination approach:

- Regulatory overview and recent developments.
- Industry climate.
- Competition in the marketplace.
- Market share for lines of business written by the company.
- Recent market entrants.
- Subsequent events known during planning related to the company's external environment.

MATERIALITY

The examiner should document planning materiality and tolerable error or thresholds and briefly explain the basis for planning materiality. The calculation and determination of materiality as well as any subsequent adjustments to materiality, should be clearly documented in an addendum to the examination planning memorandum.

SIGNIFICANT CURRENT EVENTS

Significant current events are events or conditions that may have an impact on or influence the scope of the examination or determination to rely on specific controls. Examples of significant current events include:

- RBC requirements.
- Turnover in key management, particularly financial or actuarial personnel.
- Recent changes in ownership/management/corporate structure.
- Recent changes in agency ratings.
- Entry into or departure from a significant line(s) of business.
- Recent acquisition or merger.
- Changes in mix of lines of business written.
- Issuance of surplus notes, common stock or debt.
- Recent changes in business strategy or plan.
- Changes in information technology or other areas affecting the company's internal control structure.
- Recent regulatory actions (financial and/or market).

Accounting and Reporting Issues

Identify any significant accounting or reporting issues relevant to the company's business. The following are examples:

- Permitted statutory accounting practices.
- Significant accounting transactions, such as a loss portfolio transfer, merger or financial reinsurance.
- Recently adopted statutory accounting or reporting rules applicable to the company.
- Accounting for new types of investments, such as derivatives and private placements.

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RESULTS OF PRELIMINARY ANALYTICAL REVIEW (Phase 1, Part 1, Step 3)

Briefly summarize your preliminary observations as they relate to the company's overall financial condition and operations since the last examination. The analytical review process should be performed in accordance with the off-site risk-focused analysis function. Such observations would be made from reviewing the financial analyst's work, meetings with the analyst and performing other analytical review procedures (i.e., trend analysis, common size analysis and ratio analysis). Details of this review may be attached as an exhibit to the planning memo. Examples of preliminary analytical review results would entail identifying unusual IRIS or FAST results and explanations thereof, profitability of underwriting and overall operations, the level to which the company has leveraged policyholders' surplus, composition of investment portfolio, and Jumpstart exceptions.

INFORMATION TECHNOLOGY (Phase 1, Part 1, Step 4)

Summarize the results of the general IT review, including work performed by IT examiners utilizing Exhibit C – Evaluation of Controls in Information Technology.

CORPORATE GOVERNANCE (Phase 1, Part 2)

Examinations using the risk-focused examination approach promote the assessment of risk management processes other than those that result in financial statement line item verifications—including Board of Directors' effectiveness and corporate governance activities—thus providing a prospective look at the operation and quality of the risk management process. Consideration of the aforementioned factors should be given during the planning phase of an examination, as they relate directly to the company's control environment. Examiners should summarize the overall corporate governance assessment after completing a review as outlined in Exhibit M – Understanding the Corporate Governance Structure.

A specific corporate governance memorandum may be referenced that provides additional information, such as a listing of individuals (with titles) and separate assessments of management and the Board of Directors. This memo should identify the examiners' assessment of management in terms of experience of senior staff, past performance, management approach (i..e., aggresive/conservative accounting or sales practices), recent changes or turnover, overly aggressive compensation or bonus structure, appropriate reporting channels, etc.

Interview Results

This section should document risks, both financial reporting and other than financial reporting, that are identified by the exam team as a result of conducting interviews with company personnel. The examiner can then document whether each risk should be included in a risk matrix or documented using Exhibit V – Overarching Prospective Risk Assessment.

AUDIT FUNCTION (Phase 1, Part 3)

The examiner should document the overall review of the independent auditors' workpapers and reports, including a resulting assessment of the planned reliance on or use of such work, and any testing of underlying data. The examiner should utilize Exhibit E – Audit Review Procedures to assist with this documentation. The examiner should explain the rationale of any changes in external auditors since the previous examination.

Additionally, consideration should be given to work performed by the company's auditors related to the NAIC Annual Financial Reporting Model Regulation (Model Audit Rule) and the Sarbanes-Oxley Act of 2002 (SOX). The requirements imposed by these rules provide state regulators with an enhanced ability to perform the risk assessment set forth in the risk-focused surveillance framework by leveraging off of the work performed by the company's auditors. The examiner should discuss intended reliance on work performed by internal or external auditors related to the Model Audit Rule and SOX.

KEY ACTIVITIES AND RISKS (Phase 1, Part 4 and Phase 2)

The purpose of the risk-focused surveillance process is to identify areas of high risk for concentration of efforts in order to enable more efficient use of examiners resources. This section should summarize the general process and results of

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selecting the key activities that will be addressed during the examination. If the examiner does not intend to address risks related to a specific critical risk category within one of the key activities selected, the rationale for such should be adequately documented in this memo (e.g., the examiner does not plan to address the critical risk category related to reinsurance reporting and collectibility because the insurer does not have any reinsurance agreements in place). Any additional discussion regarding the overall examination approach for specific key activities or inherent risks can be included here.

PROSPECTIVE RISKS

The examination team should document a high-level understanding of any solvency concerns that commenced or extended after the examination date, or that are anticipated to commence or extend beyond the examination completion date. This documentation should include prospective risks that do not relate to a specific key activity and may be addressed through the utilization of Exhibit V – Overarching Prospective Risk Assessment.

UTILIZATION OF INTERIM WORK

Summarize work performed in the interim period, including how that work will be rolled forward and the intended reliance on such procedures for the full-scope examination. Document the examiner's assessment of any high-level changes since interim work was performed that may have a signfiicant impact on the examination conclusions.

USE OF SPECIALISTS

Identify and document the need for and use of specialists, such as information technology, reinsurance, actuarial, tax and investment specialists. Specifically, comment on what individual and/or firm will be utilized, the overall scope of the service to be provided, a general timeline, the reporting relationship between the examiners and the specialist, how the specialist will communicate its progress (status reports, bi-weekly meetings) and the overall final product to be delivered by the specialist.

INTENDED USE OF WORK PERFORMED BY OTHERS

Once key activities and risks have been identified, the examiner can determine whether the examination team intends to utilize the work performed by other state insurance regulators, the company's external or internal auditors, risk managers, quality assurance staff, etc.

EXAM STAFFING AND TIME BUDGET

Include names and position titles of team members, including work assignments for the exam. Include any specialists or consultants utilized. An examination contact list with contact information (e.g., Name, Title, State/Location, Phone Number, E-mail Address) for each participating examiner could be attached to the planning memo.

Attach time budget with expected conclusion date of the examination.

PENDING MATTERS

List matters identified in planning meetings and review of inter-departmental correspondence that are outstanding or pending approval (e.g., request for rate increase/decrease, real estate appraisal, custodial agreement, etc.) and briefly discuss follow-up procedures planned.

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APPROVAL OF EXAMINATION PLANNING MEMORANDUM

The chief examiner or designee should review and approve the planning memo and corresponding evidence by signing and dating the memo at the end of Phase 2. The examiner-in-charge should sign and date the planning memo as well.

_____	_____
Name Chief Examiner [State] Department of Insurance	Date
_____	_____
Name Examiner-In-Charge (EIC) [State] Department of Insurance	Date

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EXHIBIT J
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EXHIBIT K
RISK ASSESSMENT MATRIX

PHASE 1

1. Identify key functional activities that require focus based on information gathered in planning and Phase 1 *(1 of Matrix).*

PHASE 2

2. Identify specific risks relating to the key activity (for risks other than financial reporting) or the critical risk category (for financial reporting risks) *(2a of Matrix).*

3. Categorize the type of risk identified in Step 4 in terms of the nine branded risk classifications *(2b of Matrix),* Examination Assertions *(2c of Matrix)* and critical risk categories *(2d of Matrix)* as described in the Phase 2 guidance.

4. Assess the inherent risk of the risks identified in Step 4 and determine:
   - Likelihood of Occurrence *(2e of Matrix);*
   - Magnitude of Impact and *(2f of Matrix);*
   - Overall Assessment of the Inherent Risk *(2g of Matrix).*

PHASE 3

5. Identify risk mitigation strategies and/or controls regarding the risk(s) determined in Step 4 *(3a of Matrix).*

6. Document and test applicable controls identified in Step 7 *(3b of Matrix).*

7. Determine the Overall Risk Mitigation/Control Assessment ratings *(3c of Matrix).*

PHASE 4

8. Assess the residual risk of each identified risk and determine:

   a. Calculated Residual Risk *(4a of Matrix).*

   b. Judgmental Residual Risk *(4b of Matrix).*

   The judgmental residual risk assessment column provides an opportunity for the examiner to make changes to the calculated level of residual risk based upon knowledge of the company and professional judgment. The examiner should document the reasons for assessing residual risk differently from the calculated residual risk.

   c. Overall Assessment of the Residual Risk *(4c of Matrix).*

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PHASE 5

9. Based on the assessment of residual risk in Step 10, determine what additional detailed examination procedures, if any, need to be performed. This column will be used to provide appropriate workpaper reference(s) to examination procedures performed *(5 of Risk Matrix)*.

PHASE 6

10. This column will be used to provide appropriate workpaper reference(s) to the Department's *(6 of Matrix)*:
    - Priority score
    - Insurer Profile Summary
    - Supervisory Plan

PHASE 7

11. Based on the examination results, prepare and provide appropriate workpaper reference(s) to the Report of Examination and Management Letter *(7 of Matrix)*.

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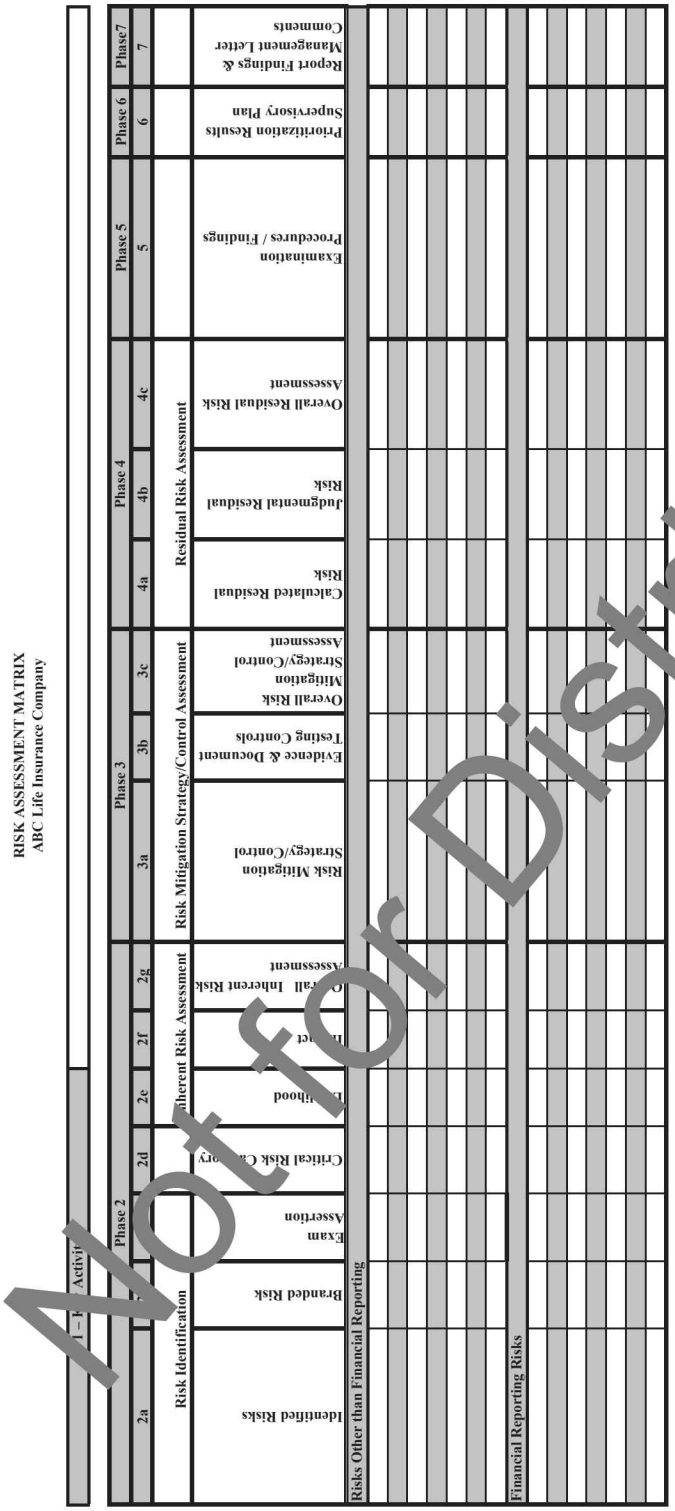

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EXHIBIT L
BRANDED RISK CLASSIFICATIONS

In order to assist examiners in categorizing identified risks, this exhibit links common risk areas and risk management controls to the branded risk classifications. This exhibit has been provided as a guide to the examiner and does not represent an all-inclusive list of risk areas or risk management controls that will be identified when obtaining an understanding of the insurer's operations. In addition, it should not be considered to be an exhaustive or definitive guide in determining the type of risk classification that would apply to each risk area, as each situation must be considered individually in the context of the insurer's environment in order to determine the appropriate branded risk classification. The nine risk classifications are to be identified in the Risk Assessment Matrix for each key activity being examined. More than one of the nine risk types may be applicable to a particular activity; as such, more than one risk type may be listed in the Risk Assessment Matrix. The following guidance is designed to help examiners think critically about the correlation between the nine risk classifications and various areas of the financial statements.

1. Credit Risk – Amounts actually collected or collectible are less than those contractually due or payments are not remitted on a timely basis.

Risk Areas to Consider:

- Level and trend of non-investment grade, problem, restructured, delinquent and non-performing earning assets.
- Existence of asset concentrations to include reinsurance recoverables and/or intercompany receivables.
- Strength of affiliates involved in reinsurance pooling or asset participation arrangements.
- Custodial arrangements.
- Materiality of agents' balances.
- Use of derivative or off-balance sheet transactions to mitigate credit risk (counter-party risk).
- Premium and other receivables (e.g., commissions, refunds, etc.).
-

Evaluating Credit Risk Management Controls (i.e., Effectiveness):

- Policies established by management and the board are comprehensive and define risk tolerances, asset allocations and accountabilities.
- Underwriting standards and risk identification processes are in place, and audited for compliance.
- Exceptions (particularly management overrides) to policies and/or processes are reported to the board.
- Through utilization of risk monitoring processes, problem assets (including agents' balances and affiliate receivables) are identified timely and collection steps initiated quickly.
- Custodial arrangements are reviewed periodically and compliance with investment laws and regulations is monitored and reported to management and the board.
- Reinsurers are evaluated regularly for financial strength.
- Information systems are accurate, dependable and validated.

2. Legal Risk – Non-conformance with applicable laws, rules, regulations, prescribed practices or ethical standards in any jurisdiction in which the entity operates will result in a disruption in business and financial loss.

Risk Areas to Consider:

- A process with assigned responsibilities is in place at the direction of senior management and the board of directors.
- Current litigation and or investigation.
- Sanctions or fines ongoing or over the past three years regarding compliance with either state or federal laws and/or regulations (including holding company considerations).

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- Compliance with:
  - Company directives for insurance contracts, underwriting and investment decisions
  - NAIC Statutory Accounting Principles and tax treatments
  - State prescribed practices

Evaluating Legal Risk Management Controls (i.e., Effectiveness):

- Reporting of compliance exceptions to management and the board.
- Communication of compliance expectations (e.g., code of conduct, conflicts of interest) throughout the organization and distribution channels.
- Involvement of legal counsel with changes to products and new product development.
- Process and reporting of changes to regulatory requirements, litigation not in the normal course of claims-paying activities (includes disputes with reinsurers).

3. Liquidity Risk – Inability to meet contractual obligations as they become due because of an inability to liquidate assets or obtain adequate funding without incurring unacceptable losses.

Risk Areas to Consider:

- Volume and growth of earning assets that are not publicly traded or do not lend themselves to securitization.
- Assessment of impaired securities (bonds, stocks, etc.).
- Investments in derivatives, securities lending and real estate.
- Sources of liquidity that are external to the insurer (particularly those available for emergencies).
- Extent of illiquid investments in affiliates (to include in working capital), including joint ventures, partnerships and limited liability companies.
- Policyholder dividends.
- Results of actuarial cash flow testing.

Evaluating Liquidity Risk Management Controls (i.e., Effectiveness):

- Policies (to include investment policy) established by management and the board reflect an understanding of managing this risk.
- Asset liability matching (ALM) analysis (i.e., scenario testing) is performed regularly for trends and reported to senior management and the board.
- Access to outside sources of liquidity (including affiliates) is adequate and available, particularly in emergencies.
- Liquidity considerations are factored into product design.
- All levels of management (i.e., short-term cash, product actuaries, product and portfolio managers) are aware of the business activities that can trigger an adverse liquidity condition.

4. Market Risk – Movement in market rates or prices — such as interest rates, foreign exchange rates or equity prices — that adversely affect the reported and/or market value of investments.

Risk Areas to Consider:

- Income on investments.
- Composition and level of primary asset classes that are susceptible to changes in value (e.g., derivative instruments, as well as policy, mortgage and collateral loans) due to changes in:
  - Stock markets.
  - Interest rates.
  - Currency exchange rates.
  - Inflation.
  - Industry sectors.
  - Global/national/regional economic conditions.

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Evaluating Market Risk Management Controls (i.e., Effectiveness):

- Policies established by management and the board reflect an understanding of managing this risk (management overrides are prohibited).
- The process of managing this risk is effective and proactive (e.g., scenario impact modeling).
- Information systems are accurate, dependable and validated.

5. Operational Risk – The risk of financial loss resulting from inadequate or failed internal processes, personnel and systems, as well as unforseen external events.

Risk Areas to Consider:

- Incorporation of the internal audit function and program.
- Monitoring and evaluation of financial and administrative internal controls as well as operational risks.
- Volume and complexity of transactions in relation to systems and hardware capacity and development.
- Internal controls to safeguard human, facility and financial assets, including antifraud initiatives and compliance with anti-money laundering requirements.
- Status of disaster recovery and business-continuity programs.

Evaluating Operational Risk Management Controls (i.e., Effectiveness):

- Policy established by the board and/or senior management reflects an understanding of this risk.
- Programs are in place to identify, monitor and evaluate operational risk.
- The audit function is qualified and possesses (or can obtain) the resources to accomplish its charter and implement the audit plan.
- Internal financial and administrative controls are monitored for effectiveness and completeness.
- The disaster recovery plan has been tested.

6. Pricing and Underwriting Risk – Pricing and underwriting practices are inadequate to provide for risks assumed.

Risk Areas to Consider:

- Composition and amount of growth in primary lines of direct, ceded and assumed business by state/territory/distribution channel.
- New and/or discontinued products.
- Primary challenges to success.
- Reliance on asset returns to cover underwriting losses.
- Use of managing general agents or other concentration of writings.
- Underwriting performance of agents, brokers and sales personnel.
- Utilization of reinsurance to generate writing capacity.
- Catastrophe reinsurance program.
- Claim assessments and projections.

Evaluating Pricing and Underwriting Risk Management Controls (i.e., Effectiveness):

- Management and the board establish realistic and comprehensive goals/objectives and evaluate results.
- Changes in product pricing/underwriting are justified and reviewed by senior management for adherence to profitability/growth plans and objectives.
- For processes that include underwriting, pricing actuary and claims staff are in place to evaluate new product performance on a timely basis and report findings to management.
- Management overrides to pricing and/or underwriting limits/decisions/policies are reported to the appropriate committee.
- Staff is competent and has appropriate level of experience.

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- Utilization of credits and/or discounts is effectively monitored and reported upon.
- There is an active and thorough audit function for the detection of errors, overrides and fraud.
- The plan of reinsurance and its effectiveness is evaluated and reported to the board.
- The risk of catastrophic loss is modeled and assessed periodically and appropriately included in pricing.
- The company is closely monitoring profitability of underwriting and pricing.
- Informational systems are accurate, dependable and validated.

7. Reputation Risk – Negative publicity, whether true or not, causes a decline in the customer base, costly litigation and/or revenue reductions.

Risk Areas to Consider:

- Customer service, current negative publicity and market conduct compliance.
- Antifraud initiatives and disaster recovery.
- Stability of financial strength ratings.
- Highly visible litigation and occurrence of same over the past three years.
- Marketing approach toward creating a positive brand relationship with the public and distribution force.
- Procedures used for claim processing.

Evaluating Reputation Risk Management Controls (i.e., Effectiveness):

- Establishment of policies/procedures by management and the board to respond to adverse publicity (include history of performance).
- Relationship with community (include distribution force).
- Contingency plans to mitigate risk in the event of a crisis.
- Process of disclosing financial performance to the public and distribution force.

8. Reserving Risk – Actual losses or other contractual payments reflected in reported reserves or other liabilities will be greater than estimated.

Risk Areas to Consider:

- Lines of business that generate significant reserves, including methods and assumptions.
- Relevance of pooling, as well as external third-party ceded/assumed reinsurance.
- Use of internal vs. external adjusting staff and claim-processing procedures.
- Use of current technology and software.
- Loss adjustment expenses.

Evaluating Reserving Risk Management Controls (i.e., Effectiveness):

- Policies established by management and the board reflect a conservative approach toward reserving and reserving practices (management's ability to override the actuary's reserve estimate is limited and reported to the board/responsible committee).
- Historically, reserve levels have developed favorably.
- Staff responsible for recommending financial statement reserve levels is competent and experienced.
- Processes are in place to reliably, accurately and timely evaluate prior and current period reserve levels (direct and net of reinsurance basis) for adequacy, and findings/recommendations are reported to senior management.
- Reinsurance ceded/assumed is considered as a separate component of the reserve.
- Claims adjudication processes are well-documented, internal controls and limits of authority are clear and present, and there is an active audit function for the detection of errors, overrides and fraud.

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- Reserving actuary obtains relevant insight from pricing actuary, claims and underwriting staff regarding emerging trends and product dynamics.
- Information systems are accurate, dependable and validated.

9. Strategic Risk – Inability to implement appropriate business plan, to make decisions, to allocate resources or to adapt to changes in the business environment will adversely affect competitive position and financial condition.

Risk Areas to Consider:

- Marketplace.
- Competition and benchmarking, as well as financial projections and economic forecasts.
- Growth and mix of business.
- Experience level of management and the board of directors.
- New and/or discontinued products/territories/distribution channels.
- Use of technology.
- Regulatory climate.
- Insurance holding company considerations.

Evaluating Strategic Risk Management Controls (i.e., Effectiveness):

- Historical and current success/failure in accomplishing stated strategic goals and operating/financial plans.
- Strategic goals (and the plans to implement them) and corporate culture are effectively communicated and applied throughout the organization.
- Initiatives and plans are well conceived, risks involved are well understood and deliberated upon by management and the board.
- Risk management systems/processes are in place to evaluate results in relation to plan expectations.
- Access to capital, particularly in emergency situations.
- Assignment of responsibilities is clear and compensation is tied to achievement.

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EXHIBIT M
UNDERSTANDING THE CORPORATE GOVERNANCE STRUCTURE

The purpose of this exhibit is to assist the examiner in documenting the understanding and assessment of an insurer's corporate governance policies and practices. As insurers are expected to demonstrate different corporate governance practices in accordance with the nature and extent of their operations, examiners should not expect the practices of each individual insurer to specifically match the guidance provided in this exhibit. Therefore, the focus of the examination team's considerations in this area should be to determine whether the practices implemented by the insurer are reasonable and effective.

The examination team should first attempt to utilize information obtained through Exhibit B – Examination Planning Questionnaire, Exhibit Y – Examination Interviews and other planning sources (including information provided to the financial analyst and any other information available to the examiner) before requesting any additional information that may be necessary to gain an understanding and perform an assessment of corporate governance. A favorable overall assessment of governance does not, by itself, serve to reduce the scope or extent of examination procedures; rather, specific governance controls need to be assessed for their adequacy of the management of specific risks, in conjunction with other controls designed to manage the same.

In conducting examinations of insurers that are part of a holding company group, the work to gain an understanding and assess corporate governance should focus on the level at which insurance operations are directly overseen (e.g., ultimate parent company level, insurance holding company level, legal entity level, etc.). However, in certain areas, it may be necessary to review governance activities occurring at a level above or below the primary level of focus. Many critical aspects of governance usually occur at the holding company level. The exam team should seek to coordinate the review and assessment of group corporate governance in accordance with the exam coordination framework and lead state approach outlined in Section 1 of this Handbook. Where possible in a coordinated examination, the lead state's work on the corporate governance assessment should be utilized to prevent duplication of effort and to leverage examination efficiencies. Additionally, the examiner should utilize the Corporate Governance Annual Disclosure (CGAD), which is required to be filed with the Department of Insurance (DOI) annually in accordance with the *Corporate Governance Annual Disclosure Model Act* (#305) and *Corporate Governance Annual Disclosure Model Regulation* (#306). The CGAD provides a narrative description of the insurer's or insurance group's corporate governance framework and structure and may enhance examination efficiencies when leveraged. Examiners should also ensure they understand/leverage the Holding Company Analysis work performed by the lead state's financial analyst to understand and assess the company's corporate governance, as well as the filings noted above.

A. ASSESSING THE BOARD OF DIRECTORS

An assessment of the board of directors may be determined through discussions with the board of directors and through gaining an understanding of the board's oversight role. The overall assessment should cover the suitability of board members, as well as the suitability policies and practices of the board as a whole. As a general guideline, the following areas should be considered in the assessment of the board of directors:

1. Are membership criteria and terms for the board of directors sufficient to enable the effective monitoring and oversight of management?

2. Are board members suitable for their respective roles in supporting the overall objectives of the insurer? An assessment of suitability may include consideration of knowledge, experience, competence and integrity of [illegible]

3. Does the board of directors effectively monitor and oversee management activities?

4. Is the board of directors sufficiently independent from management such that, when necessary, difficult and probing questions are raised? If not independent, what compensating factors, if any, exist to ensure that, when necessary, difficult and probing questions will be raised with or considered by management?

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5. What is the frequency and timeliness with which meetings are held with chief financial and/or accounting officers, internal auditors and external auditors?

6. Is the information provided to the board of directors or committee members sufficient and timely enough to allow monitoring of management's objectives and strategies, the entity's financial position and operating results, and terms of significant agreements?

7. Is there a formal process through which the board of directors or audit committee is apprised of sensitive information, investigations and improper acts (e.g., travel expenses of senior officers, significant litigation, investigations of regulatory agencies, defalcations, embezzlement or misuse of corporate assets, violations of insider trading rules, political payments, illegal payments) sufficiently and in a timely manner?

An active and effective board of directors, or underlying committee, provides an important oversight function. In addition, because of management's ability to override system controls, the board of directors plays an important role in ensuring effective internal control, setting the "tone at the top" and setting other management standards that may affect the risk analysis for the company's activities. Key components include:

1. Independence from management such that, when necessary, difficult and probing questions are raised. For example, consider:
   a. Whether the board of directors constructively challenges management's planned decisions (e.g., strategic initiatives and major transactions) and probes for explanations of past results (e.g., budget variances).
   b. Whether a board of directors that consists solely of an entity's officers and employees (e.g., a small corporation) questions and scrutinizes activities, presents alternative views and takes appropriate action if necessary.
   c. The leadership structure of the board. Have there been changes during the exam period? Has the company chosen to combine or separate the principal executive officer from the Chairman of the Board? Why or why not?
   d. If there is a lead independent director. What role does that person play in the leadership of the company?
   e. If there are any other arrangements intended to ensure that, when necessary, difficult and probing questions are raised with or considered by management. If so, what are they?

2. The use of board committees, where warranted, by the need for more in-depth or directed attention to particular matters. For example, consider whether:
   a. Board committees exist.
   b. They are sufficient in subject matter and membership, to deal with important issues adequately.

3. The knowledge, integrity and experience of directors. For example, consider:
   a. Whether directors have sufficient knowledge, applicable industry experience and time to serve effectively.
   b. Whether directors have demonstrated integrity through their business conduct.
      A review of biographical data and background checks performed on directors may provide evidence of appropriate background, integrity and experience from the company licensing process, *Insurance Holding Company System Regulatory Act* (#440) filings, SEC filings, exam planning questionnaires, additional information gathered as a result of the risk-focused surveillance framework, etc.
   c. Changes in board composition during the examination period, including those that have broadened the experience of the directors as a whole.
   d. The criteria for identifying board of director candidates.

4. The frequency and timeliness with which meetings are held with chief financial and/or accounting officers, internal auditors and external auditors. For example, consider whether:
   a. The audit committee meets privately with the chief accounting officer and internal and external auditors to discuss the reasonableness of the financial reporting process, system of internal control, significant comments and recommendations, and management's performance.

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b. The audit committee reviews the scope of activities of the internal and external auditors annually.

5. The sufficiency and timeliness with which information is provided to the board of directors or committee members, to allow monitoring of management's objectives and strategies, the entity's financial position and operating results, and terms of significant agreements. For example, consider whether:
   a. The board of directors regularly receives key financial information, such as company financial statements and related analysis, the financial results of significant affiliates and business partners and changes to significant contracts.
   b. The board of directors regularly receives key information on strategic risk areas, such as investment strategies and results, reinsurance strategies and results, major marketing initiatives, results of negotiations and information on reasonably foreseeable prospective risks.
   c. The board of directors regularly receives key information on the actuarial function of the organization, such as reports and presentations on the adequacy of reserve provisions, the effectiveness of internal controls, and the prospective solvency position of the insurer.
   d. Directors believe they receive the proper information in a timely and effective manner.

6. The oversight in determining the compensation of executive officers and head of internal audit, and the appointment and termination of those individuals. Smaller or non-public companies are less likely to have the types of compensation policies and practices of larger, publicly traded companies, so the examination should take that fact into consideration. Some examples to consider may include:
   a. Whether the compensation committee, or board, approves executives' incentive compensation plans.
   b. The general design philosophy of compensation and incentive programs.
   c. Whether the board or compensation committee considers how to eliminate, reduce, or manage material adverse risks to the company that may arise from compensation practices.
   d. Whether there have been any changes in executive compensation plans during the exam period. Review applicable SEC filings and the NAIC Supplemental Compensation Exhibit.
   e. The nature and extent of services provided by compensation consultants during the exam period. Are all services approved by the board of directors or compensation committee? How are independent compensation consultants selected and to whom do they report?
   f. How are management compensation programs reviewed for effectiveness?
   g. What is the process by which changes in compensation programs are approved?
   h. Does the compensation policy induce excessive or inappropriate risk-taking?
   i. Is the compensation policy in line with the identified risk appetite and long-term interests of the insurer with proper regard to the interests of the stakeholders?

7. The board's role in establishing the appropriate "tone at the top." For example, consider whether:
   a. The board and audit committee are involved sufficiently in evaluating the effectiveness of the "tone at the top."
   b. The board of directors takes steps to ensure an appropriate tone.
   c. The board of directors specifically addresses management's adherence to the code of conduct.
   d. The board of directors has developed an adequate conflict of interest policy for officers, management and key personnel.

8. The actions that the board of directors or committee takes as a result of its findings, including special investigations, as needed. For example, consider whether:
   a. The board of directors has issued directives to management detailing specific actions to be taken.
   b. The board of directors oversees and follows up as needed.

B. UNDERSTANDING THE ORGANIZATIONAL STRUCTURE

The organizational structure should not be so simple that it cannot adequately monitor the enterprise's activities, nor so complex that it inhibits the necessary flow of information. Executives should fully understand their control responsibilities and possess the requisite experience and levels of knowledge commensurate with their positions. Key components include:

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1. The appropriateness of the entity's organizational structure, and its ability to provide the necessary information flow to manage its activities. For example, consider whether:
    a. The organizational structure is appropriately centralized or decentralized, given the nature of the entity's operations.
    b. The structure facilitates the flow of information upstream, downstream and across all business activities.
    c. Checks and balances exist and are working as intended, allowing for flexibility and responsiveness in the timeliness of decision-making, transparency and concentration of power within the organization.
    d. For insurance groups, consider if group-wide governance policies address risks and objectives at the legal entity level and at the group level.

2. The adequacy of the definition of key managers' responsibilities, and their understanding of these responsibilities. For example, consider whether:
    a. Responsibilities and expectations for the entity's business activities are communicated clearly to the executives in charge of those activities.

3. The adequacy of knowledge and experience of key managers in light of responsibilities. For example, consider whether:
    a. The executives in charge have the required knowledge, experience and training to perform their duties.
    b. Key managers understand their responsibilities regarding the insurer's risk policies/appetites and internal controls.

4. The appropriateness of reporting relationships. For example, consider whether:
    a. Established reporting relationships—formal or informal, direct or indirect—are effective and provide managers with information appropriate to their responsibilities and authority.
    b. The management of the business activities has access to senior operating executives through clear communication channels. The internal audit function reports directly to the board of directors or to the audit committee.

5. The extent to which modifications to the organizational structure and business strategy are made or planned in light of changing conditions. For example, consider whether:
    a. Management periodically evaluates the entity's organizational structure in light of changes in the business or industry.
    b. For large insurance groups with significant affiliate relationships and interconnectivity (including systemically important financial institutions as designated by the Financial Stability Oversight Council) , the board and management is involved in developing and reviewing resolution/contingency plans to be implemented in the event of company failure.

6. Sufficiency in the number of employees, particularly in management and supervisory capacities. For example, consider whether:
    a. Managers and supervisors have sufficient time to carry out their responsibilities effectively.
    b. Managers and supervisors work excessive overtime and/or are fulfilling the responsibilities of more than one employee.
    c. The insurer has succession plans established to replace/retain key employees.

7. The extent of accountability maintained for material activities or functions outsourced to an external party. For example, consider whether:
    a. Outsourced activities and functions are subject to periodic reviews by the insurer or an independent third party.
    b. Outsourced activities and functions are subject to the same degree of accountability as non-outsourced activities and functions.

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C. UNDERSTANDING THE ASSIGNMENT OF AUTHORITY AND RESPONSIBILITY

The assignment of responsibility, delegation of authority and establishment of related policies provide a basis for accountability and control, and set forth individuals' respective roles. Key components include:

1. The assignment of responsibility and delegation of authority to deal with organizational goals and objectives, operating functions and regulatory requirements, including responsibility for information systems and authorizations for changes. For example, consider whether:
   a. Authority and responsibility are assigned to employees throughout the entity.
   b. Responsibility for decisions is related to assignment of authority and responsibility.
   c. Proper information is considered in determining the level of authority and scope of responsibility assigned to an individual.

2. The appropriateness of control-related standards and procedures, including employee job descriptions. For example, consider whether:
   a. Job descriptions, for at least management and supervisory personnel, exist.
   b. The job descriptions, or other standards and procedures, contain specific references to control-related responsibilities.

3. The appropriateness of staff size, particularly with respect to information systems, actuarial and accounting functions, with the requisite skill levels relative to the size of the entity and nature and complexity of activities and systems. For example, consider whether:
   a. The entity has an adequate workforce—in number and experience—to carry out its mission.

4. The appropriateness of delegated authority in relation to assigned responsibilities. For example, consider whether:
   a. There is an appropriate balance between authority needed to "get the job done" and the involvement of senior personnel where needed.
   b. Employees at the appropriate level are empowered to correct problems or implement improvements, and empowerment is accompanied by appropriate levels of competence and clear boundaries of authority.

D. ASSESSING MANAGEMENT

A quality assessment of management may be determined through discussions and observations of the governance processes. This assessment should cover both the suitability of individual members of management as well as the suitability, policies and practices of management as a whole. As a general guideline, the following areas should be included in the assessment of management suitability.

1. Do key members of management appear to be suitable for their respective roles? Do they appear to possess the necessary competence and integrity for their positions?

2. How long has key management been with the company in their current positions, and what specific industry experience do they have?

3. Has there been significant turnover in management?

4. Have members of management ever been officers, directors, trustees, key employees or controlling stockholders of an insurance company that, while they occupied any such position or served in any such capacity with respect to it:
   a. Became insolvent or was placed in conservation?
   b. Was placed into supervision or rehabilitation?
   c. Was enjoined from, or ordered to cease and desist from, violating any securities or insurance law or regulation?
   d. Suffered the suspension or revocation of its certificate of authority or license to do business in any state?

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In addition to the assessment of management suitability, examiners should make an assessment of management's performance. The following areas should be considered when assessing management performance.

1. Does management periodically review information to adequately assess the impact of changes in competition, technology, regulation, environment and general economic trends that may impact the company's business?

2. Does management have adequate financial and operating information to identify trends or variations from budgets that may impact the statutory financial statements?

3. Does management effectively analyze and investigate financial and operating information and trends such that significant adverse trends or misstatements in the annual financial statement could reasonably be expected to be identified and rectified on a timely basis?

4. Do management, supervisors and agents have appropriate knowledge and experience to capably and effectively administer management's policies and procedures?

5. Does the company maintain effective controls to ensure that potential short-term liquidity problems, long-term capital needs and other significant fund management variations/needs are identified and rectified on a timely basis?

6. Do adequate physical safeguards exist over company assets, and are all officers and their employees appropriately bonded? (See Exhibit R – Suggested Minimum Amounts of Fidelity Insurance for assistance.)

7. Does management have a positive attitude toward internal controls (including controls over the information systems)?

8. Does management have adequate financial and operating information to identify, on a timely basis, potential liabilities, commitments and/or contingencies that may require recording and/or disclosure in the annual financial statement?

9. Does management regularly obtain and review key information on strategic risks, including investment strategies and results, reserving methodologies and results, reinsurance strategies and results, and information on reasonably foreseeable prospective risks?

As an expansion of the sample evaluative guidance above, the philosophy and operating style of management will normally have a pervasive effect on an entity. These are intangibles, but one can look for positive and negative signs. Key components include:

1. The nature of business risks accepted (e.g., whether management often enters into particularly high-risk ventures or is extremely conservative in accepting risks). For example, consider whether:
    a. Management moves carefully, proceeding only after carefully analyzing the risks and potential benefits of a venture.

2. Personnel turnover in key functions (e.g., operating, actuarial, accounting, information systems, internal audit). For example, consider whether:
    a. There has been excessive turnover of management and supervisory personnel.
    b. Key personnel have quit unexpectedly or on short notice.
    c. There is a pattern to turnover (e.g., inability to retain key financial or internal audit executives) that may be an indicator of the emphasis that management places on control.

3. Management's attitude toward the information systems and accounting functions, and concerns about the reliability of financial reporting and safeguarding of assets. For example, consider whether:
    a. The accounting function is viewed as a necessary group of checks and balances, or as a vehicle for exercising control over the entity's various activities.

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b. The selection of accounting principles used in financial statements always results in the highest reported income.
c. Operating unit accounting personnel also have the responsibility to report to or communicate with central financial officers.
d. Valuable assets, including intellectual assets and information, are protected from unauthorized access or use.

4. Frequency of interaction between senior management and operating management, particularly when operating from geographically removed locations. For example, consider whether:
   a. Senior managers frequently visit subsidiary or divisional operations.
   b. Group or divisional management meetings are held frequently.

5. Attitudes and actions toward financial reporting, including disputes over the application of accounting treatments (e.g., selection of conservative vs. liberal accounting policies; whether accounting principles have been misapplied, important financial information not disclosed, or records manipulated or falsified). For example, consider whether:
   a. Management avoids obsessive focus on short-term reported results.
   b. Personnel do not submit inappropriate reports to meet targets.
   c. Managers do not ignore signs of inappropriate practices.
   d. Estimates do not stretch facts to the edge of reasonableness and beyond.

Management should provide effective oversight of the insurer's actuarial function in evaluating and providing advice to the insurer in respect to technical provisions, premium, pricing, and reserving activities, and compliance with related statutory and regulatory requirements. While various components of an actuarial function can be provided internally or outsourced to an external third party, the following elements should be considered in understanding and assessing the insurer's governance practices in this area:

1. Are individuals within the insurer's actuarial function suitable for their respective roles? Do they possess the necessary competence and integrity for their positions?
   a. Does the insurer's appointed actuary maintain current actuarial credentials with an appropriate professional organization (e.g., FCAS, MAAA, etc.)?
   b. Does the appointed actuary have experience in the lines of business written by the company?
   c. Do others within the company's actuarial function have the appropriate knowledge, experience and background to function in the roles assigned to them?

2. Does the insurer's actuarial function provide advice on actuarial matters to management as appropriate based on the size and complexity of the entity? Key components include:
   a. The insurer's actuarial and financial risks.
   b. The insurer's current and prospective solvency position.
   c. Risk-assessment and risk-management policies and controls relevant to actuarial matters or the financial condition of the insurer.
   d. Distribution of policy dividend or other benefits.
   e. Underwriting policies.
   f. Reinsurance arrangements.
   g. Product development and design, including the terms and conditions of insurance contracts.
   h. The sufficiency and quality of data used in the calculation of technical provisions.
   i. Risk modeling and use of internal models in risk management.

3. Does the insurer have appropriate segregation of duties between its actuarial function and executive management to ensure that:
   a. Recorded reserves reflect an appropriate actuarial estimate (P&C and Health).
   b. The company books the actuary's best estimate each year (P&C).
   c. If the company's recorded reserves differ from the actuary's best estimate, the rationale for such deviation is appropriately documented and presented to the board of directors (P&C).

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d. The company's appointed actuary has submitted a report to the Board of Directors on reserve adequacy (All Lines)?

E. REVIEWING THE RISK MANAGEMENT FUNCTION

A review of the entity's risk management function should be conducted through discussions with senior management and the board of directors and through gaining an understanding of the risk management function including inspection of relevant risk management documentation. For companies subject to the Own Risk and Solvency Assessment (ORSA), a review of the ORSA summary report—including completion of the ORSA Documentation Template in Section 1, Part X of this Handbook—may be used in place of completing this section. For companies that do not submit an ORSA summary report, the ORSA guidance contained in this Handbook may still be a helpful tool for the examiner to consider in assessing the maturity of an insurer's risk-management framework, which should include the assessment of each of five key principles. While each of the key principles can be applicable to all insurers, it is important to consider variations in size and complexity and alter expectations appropriately. As a general guideline, the following areas should be considered in conducting a review of the risk-management function:

1. Risk Culture and Governance
    a. What kind of risk-management culture is demonstrated throughout the organization? What does the culture indicate regarding the importance of risk management to the organization?

2. Risk Identification and Prioritization
    a. How are existing risks identified, monitored, evaluated and responded to? Does risk assessment take probability, potential impact and time duration into account?
    b. How are emerging and/or prospective risks identified, monitored, evaluated and responded to?

3. Risk Appetite, Tolerances and Limits
    a. How are risk tolerances, appetites and limits defined and communicated throughout the organization? Does the insurer maintain appropriate policies outlining specific obligations of employees in dealing with risk?
    b. How does the organization use the risk information it gathers to determine its capital needs?

4. Risk Management and Controls
    a. How are responsibilities for risk-management functions delegated and monitored within the organization?

5. Risk Reporting and Communication
    a. What is the involvement of the board of directors in the risk-management function of the organization?

An effective risk-management function is essential in providing effective corporate governance over financial solvency. During the latter phases of the risk-focused examination, the examiner will document a review of the entity's individual risk-management functions within the system. However, during a review of the entity's corporate governance, the examiner should document the review of the entity's risk-management function as a whole, as well as its place and importance in the entity's corporate governance structure. For ORSA companies, the knowledge gained in performing a review and assessment of enterprise risk management (ERM) may also be utilized to gain efficiencies, if appropriate, in accordance with the insurer's assessed maturity level, in the latter phases of the risk-focused examination as described in Section 1, Part X of this Handbook.

F. DOCUMENTATION

The examination team should document its understanding and assessment of the entity's governance, as well as its assessment on the related impact on the examination. This summary should include a description of any unique examination procedures, including special inquiries that are considered necessary to any significant risks identified as a result of the assessment.

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The Risk Assessment Matrix, as the central documentation tool, should be utilized for the identification and assessment of individual solvency risks requiring review through the risk assessment process. However, documentation on the understanding and assessment of corporate governance is at the discretion of the examiner and would not typically be presented in a Risk Assessment Matrix. For most companies, a memorandum and/or corresponding documentation in the electronic workpapers addressing the items presented in this exhibit should provide sufficient documentation. For example, the documentation could summarize the attributes and techniques supporting the examiner's overall evaluation, any resulting examination scope implications, and the approach used to validate the more significant attributes and techniques. For smaller companies, documentation of the examination's consideration of corporate governance may be provided in the appropriate section of Exhibit I – Examination Planning Memorandum.

Specific findings or concerns related to an insurer's corporate governance practices should be accumulated for inclusion in a management letter (or similar document) to provide feedback and recommendations to the insurer. In addition, it may be necessary for the examination to document information on the corporate governance assessment for communication back to the financial analyst through the use of Exhibit AA – Summary Review Memorandum (or similar document).

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EXHIBIT N
REINSURANCE REVIEW

This exhibit includes items that may be useful to examiners while conducting a review of the reinsurance contracts and programs in place at an individual insurer. Part One of the exhibit provides an example letter of credit form that may be used by companies and referenced by examiners in determining whether letters held by the company are acceptable as a basis for receiving a credit for unauthorized reinsurance. Part Two provides a form that may be used by reinsurers applying for accredited or authorized status in states which they are not licensed. This form, entitled Form A-1, may be submitted as evidence of a company's compliance with requirements to designate the Commissioner as agent for receipt of service of process and to recognize the Commissioner's authority to examine the company's books and records. Part Three of the exhibit provides a ceded reinsurance contract review form that may assist the examiner in determining whether required elements have been included in the contract and in determining whether the contract includes a valid transfer of risk. Each of the items included within this exhibit should be utilized in conjunction with guidance provided in Section 1, Part V- Reinsurance Review.

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PART ONE — EXAMPLE LETTER OF CREDIT FORM

(Name of Bank)
(Address)

FOR INTERNAL IDENTIFICATION PURPOSE ONLY

Date _____ ID No. _____ Issuing Bank No. _____

Clean, Irrevocable, Unconditional Letter of Credit No.:_____

Account Holder (Reinsured):_____

Issuing Bank:_____

Beneficiary (Reinsured):_____

Amount:_____ Expiration Date:_____

Date _____

Clean, Irrevocable Unconditional Letter of Credit No.:_____

To Beneficiary: (Name)_____

(Address)_____

Dear Sir or Madam:

We have established this clean, irrevocable, and unconditional letter of credit in your favor for drawing up to U.S. $_____ effective immediately and expiring at our (bank address) with our close of business on _____. Except when the amount of this letter of credit is increased, this credit cannot be modified or revoked without your consent.

We hereby undertake to promptly honor your sight draft(s) drawn on us, indicating our credit No. _____, for all or any part of this credit upon presentation of your draft drawn on us at our offices prior to the expiration date hereof.

The term "Beneficiary" as used herein includes any successor by operation of law of the named Beneficiary including, without limitation, any liquidator, rehabiliatator, receiver or conservator.*

Except as stated herein, this undertaking is not subject to any requirement or qualification. Our obligation under this letter of credit is the individual obligation of _____ Bank, in no way contingent upon reimbursement with respect thereto, or upon our ability to perfect any lien or security interest.

This letter of credit expires on _____, but will automatically extend without amendment for one year from the expiration date or any future expiration date, unless 30 days prior to such expiration date, we notify you by registered mail that this letter of credit will not be renewed.

This letter of credit is subject to the Uniform Customs and Practice for Documentary Credits International Chamber of Commerce Publication No. 600 (UCP 600), or its successor, as well as the International Standby Practices Publication No. 590 (ISP98). Notwithstanding Article 17 of said publication (or its successor), in the event that one or more of the occurrences specified occurs, then the bank hereby specifically agrees that this letter of credit shall be extended so as not to expire during such interruption of business and shall extend for 10 days after such resumption of business.

_____ _____
Signature Title

*If the named Beneficiary is a California domestic insurer, this paragraph should be deleted and replaced by: "The term Beneficiary as used herein includes and is limited to the court appointed domiciliary receiver, conservator, rehabilitator or liquidator."

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PART TWO — EXAMPLE FORM AR-1 CERTIFICATE OF ASSUMING INSURER

I, (name of officer) (title of officer)

of (name of assuming insurer) the assuming insurer

under a reinsurance agreement with one or more insurers domiciled in

(name of state) hereby certifies that

(name of assuming insurer) ("Assuming Insurer"):

1. Submits to the jurisdiction of any court competent jurisdiction in (ceding insurer's state of domicile)

for the adjudication of any issues arising out of the reinsurance agreement, agrees to comply with all requirements necessary to give such court jurisdiction, and will abide by the final decision of such court or any appellate court in the event of an appeal. Nothing in this paragraph constitutes or should be understood to constitute a waiver of the Assuming Insurer's rights to commence an action in any court of competent jurisdiction in the United States, to remove an action to a United States District Court, or to seek a transfer of a case to another court as permitted by the laws of the United States or of any state in the United States. This paragraph is not intended to conflict with or override the obligation of the parties to the reinsurance agreement to arbitrate their dispute if such an obligation is created in the agreement.

2. Designates the Insurance Commissioner of (ceding insurer's state of domicile)

as its lawful attorney upon whom may be served any lawful process in any action, suit or proceeding arising out of the reinsurance agreement instituted by or on behalf of the ceding insurer.

3. Submits to the authority of the Insurance Commissioner of (ceding insurer's state of domicile)

to examine its books and records and agrees to bear the expense of any such examination.

4. Submits with this form a current list of insurers domiciled in (ceding insurer's state of domicile)

reinsured by the Assuming Insurer and undertakes to submit additions to or deletions from the list to the Insurance Commissioner at least once per calendar quarter.

Dated:

(name of assuming insurer)

By:

(name of officer)

(title of officer)

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PART THREE — CEDED REINSURANCE CONTRACT REVIEW

The examiner should complete the following workpaper in accordance with the review of the company's ceded reinsurance contracts. For those items that are not applicable, indicate N/A:

1. Affiliated transaction (Y/N)? _____
2. Treaty of certificated number: _____
3. Name of reinsured: _____
4. Name of reinsurer and authorization status (Authorized/Unauthorized):

   _____

   _____
5. Do all reinsurers meet the company's minimum acceptability standards?

   _____
6. Does collateral meet the NAIC standards? Document the collateral provided by the unauthorized reinsurers:

   _____

   _____

   _____
7. Document any reinsurance intermediaries used: _____

   _____
8. Document the type of the reinsurance contract, the effective date, expiration date and the date the contract was signed by both parties: _____

   _____

   _____
9. Identify and document the contract termination provisions: _____

   _____
10. Identify and document whether the following insurance clauses are included in the contract:

    Insolvency clause: _____

    Arbitration clause: _____

    Intermediary clause: _____

    Errors & Omissions clause: _____
11. Document the classes or line of business reinsured: _____
12. Document any exclusions noted in the contract: _____
13. Does the agreement apply on a "loss occurring" or on a "risks attaching" basis? _____
14. Document the territory the contract covers: _____

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15. Does the agreement cover losses occurred prior to its inception date? If so, verify that the contract has been properly accounted as retroactive reinsurance: _____

_____

16. Document the company's retention under the contract: _____

17. Does the contract contain a "loss corridor" provision? _____

18. Indicate the reinsurer's limits under the contract: _____

_____

19. Is there an aggregate limitation applicable to a period of coverage, a single loss event, or the agreement overall?

20. Document the premium stipulations set forth in the contract:

Annual reinsurance premium: _____

Minimum reinsurance premium: _____

Deposit premium: _____

Date premiums are adjustable: _____

21. Determine whether the reinsurance rate or premiums are adjustable based on loss experience. If they are adjustable, indicate the minimum and maximum level, how often they can be adjusted, whether adjustments have resulted in a deficit or credit carry forward, and that premium adjustments have been properly accrued:

_____

22. Identify the contract settlement provisions. Determine the payment schedules, adjustable retention provisions, accumulating retentions from multiple years or other provisions which serve to defer settlement of the reinsurer's obligations: _____

_____

23. Determine whether a managing general agent produced the reinsurance contract. Document the MGAs responsibilities regarding the reinsurance arrangement: _____

_____

24. Determine how often the reports of premiums/losses are to be rendered: _____

25. Does the agreement contain a "cash call" provision? _____

26. Is there a significant transfer of risk (underwriting and timing)? If not, has the deposit method of accounting been properly followed? (Refer to Section 1 - Part V of this handbook.) Does a cash flow analysis need to be performed? *Note: Examiners are encouraged to review Property & Casualty Interrogatory 9 and the Reinsurance Summary Supplemental Filing to determine if the company utilizes any contracts that have common characteristics of Finite Reinsurance.* _____

_____

27. Is the reinsurance credit taken by the company consistent with the provisions of the contract? _____

_____

28. Identify and document any amendments or addenda to the contract: _____

_____

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EXHIBIT O
EXAMINATION SAMPLING WORKSHEETS

This exhibit includes three worksheets that may be useful to examiners in documenting the process to conduct test procedures through the use of examination sampling. Part One of the exhibit provides a worksheet to be used when conducting sampling for use in control testing in Phase 3. Parts Two and Three provide worksheets to be used when conducting non-statistical sampling or attribute sampling for tests of details in Phase 5. Each of the worksheets within this exhibit should be utilized in conjunction with guidance provided in Section 1 – Part III, C, when applicable.

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PART ONE - TEST OF CONTROLS SAMPLING WORKSHEET

Company Name:
Exam As Of Date:
Key Activity:
Identified Risk:

Prepared by & date:
Reviewed by & date:

1. Determine the control being tested

2. Describe the objective of the test:

3. Define the population (including source or report name) and an individual sampling unit:

4. Define the period covered by the test:

5. Describe how completeness of the population was considered:

6. Define a deviation (error):

7. Determine the sample size using the table below:

Sample Sizes for Controls		
Control Frequency	**Control Occurrences**	**Sample S**
Annual	**1**	
Quarterly	**4**	2
Monthly	**12**	3-5*
Weekly	**52**	2*
Daily	**2**	25

* - Sample size should be towards the high end of the range if planned level of risk management is Strong.

8. Select the sample (Note: this may be reflected on the actual testing spreadsheet). Sample items should be selected in a manner that gives each item in the population an equal chance to be selected:

9. Document the number of deviations from the testing of controls:

Explain the type of deviations found and explain the reasons for such deviations:

Dev. #1
Dev. #2
Dev. #3

10. Conclude on the final assessed level of risk management and the acceptability of test results. In general, if any deviations are found that cannot be explained as isolated incidences, the final assessed level of risk management should be weak. Also, discuss any other matters deemed relevant to the test of controls documented above:

Final Assessed Level of Risk Management:

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PART TWO - NON-STATISTICAL SAMPLING WORKSHEET

Company Name:		Prepared by & date:	
Exam As Of Date:		Reviewed by & date:	
Key Activity:			
Identified Risk:			
Residual Risk:			

1. Describe the objective of the test:

2. Define the population (including report name), population characteristics and an individual sampling unit:

3. Describe how completeness of the population was considered:

4. Determine individually significant items:

A.	Planning materiality (PM)		
B.	Multiplied By:	50%	*
C = A x B	Tolerable Error (% of PM)	$ -	
D	Multiplied By:	1/3	*
C x D	Individually Significant Dollar Amount (based on Tolerable Error)	$ -	-Items over this amount should be 100% tested

* These items are general guidelines and can be adjusted if necessary. Additional information can be found in the Examiners Handbook.

5. Stratify the population (*Part 1*) and the sample (*Part 2*):

	Description	Population (*Part 1*)		Sample (*Part 2*)		% of Total
		Number	$ Amount	Number	$ Amount	Population ($)
Items to be Tested 100%		-	$ -	-	$ -	0.0%
Stratum 1						
Stratum 2						
Stratum 3						
Items Tested in Other Ways (A)						
Items Not to be Tested (B)						
TOTAL		-	$ -	-	$ -	
Percentage of Population Tested				0.0%	0.0%	

(A) Indicate the "other ways" used to test these

(B) Indicate why these items were not tested

6. Determine the assurance factor:

Identify other exam procedures to be used that will provide assurance in this exam area. Examples include analytical review procedures, cutoffs, and testing subsequent collections:

Residual Risk (as decided above):	0
Degree of Reliance to be Placed on Other Exam Procedures	

Residual Risk	Degree of Reliance on Other Phase 5 Procedures		
	Low	Moderate	High
High	3.0	2.3	1.9
Moderate	2.3	1.9	1.2
Low	1.9	1.2	0.9

Assurance Factor:	#N/A

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7. Calculate the sample size:

A.	Total Population Amount (From #5):	$ -
B.	Items to be Tested 100% (From #5):	$ -
C.	Items Tested by Other Ways and Items Not to be Tested (From #5):	$ -
D.	Tolerable Error (From #4):	$ -
E.	Assurance Factor (From #6):	#N/A
(A-B-C)/D x E	Sample Size:	UNKNOWN

Final Sample Size: **

** The examiner may use professional judgment to adjust the final sample size if the sample size calculated above is not deemed to be appropriate. Describe the reasons for adjusting the sample size.

Allocate the sample size among the sampling strata. Describe the basis of allocation (i.e. per $ in strata, per items in strata, other)

8. Select the sample and perform testing.

9. Determine the total error:

		Strata #1	Strata #2	Strata #3	Total
A.	$ Amount of Error in Sample	$ -	$ -	$ -	
B.	$ Amount of Strata's Sample	$ -	$ -	$ -	
C.	$ Amount of Strata's Population	$ -	$ -	$ -	$ -
D=(A/B x C)	Projected Error	$ -	$ -	$ -	$ -
E.	$ Amount of Error in Items Tested 100%				
D+E	Total Error				$ -

Explain general reasons for errors and determine whether the projected error or total error should be recorded as exam adjustments:

10. Conclude on the acceptability of test results and any modifications to the overall plan. Discuss $ and % tested of total population, total error in regards to tolerable error, likelihood of material misstatement in the remaining balance.

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PART THREE - ATTRIBUTE SAMPLING WORKSHEET

Company Name:		Prepared by & date:	
Exam As Of Date:		Reviewed by & date:	
Key Activity:			
Identified Risk:			
Residual Risk:			

1. Describe the objective of the test:

2. Define the period covered by the test:

3. Define the population (including report name), population characteristics and an individual sampling unit:

4. Describe how completeness of the population was considered:

5. Define a deviation (error):

6. Determine Selection Technique:

7. Determine the Sample Size:

Determining a Sample Size

Use the number of sampling units within the defined population and the desired level of evidence to determine your sample size.

**Assumes zero exceptions*

	Residual Risk			
Number of Items in Population	**Moderate** (with reliance on other Phase 5 procedures)	**Moderate** (no reliance on other Phase 5 procedures)	**High** (with reliance on other Phase 5 procedures)	**High** (no reliance on other Phase 5 procedures)
Less than 250	*Use Professional Judgment*			
250 or more	**20**	**40**	**60**	**80**

	*Perform testing and determine the number of exceptions identified.
*If 0 exceptions identified:	The results of the test can be accepted. No further work is necessary.
*If 1 exception identified:	Expand the testing population using the chart below to add selections to those already tested.
*If 2 or more exceptions identified:	Talk to the company to determine what is causing the high error rate and consider alternative procedures.

Add the amounts from this chart to your original sample size if 1 exception was identified.

Number of Items in Population	**Moderate** (with reliance on other Phase 5 procedures)	**Moderate** (no reliance on other Phase 5 procedures)	**High** (with reliance on other Phase 5 procedures)	**High** (no reliance on other Phase 5 procedures)
Less than 250	*Use Professional Judgment*			
250 or more	**+10**	**+20**	**+30**	**+40**
Total Sample Size	**30**	**60**	**90**	**120**

	*Perform testing on the additional selections. Determine the number of exceptions identified in the additional selections.
*If 0 exceptions identified:	The results of the test can be accepted. No further work is necessary.
*If additional exceptions noted:	Talk to the company to determine what is causing the high error rate and consider alternative procedures.

Sample Size Selection:

8. Conclusion of the results:

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EXHIBIT P
REVIEW OF EVENTS SUBSEQUENT TO THE EXAMINATION PERIOD

Company_____Examination Date_____Approved by_____

Generally, the period of review of post-balance sheet events extends from the date of the balance sheet to the date of the examination report, which, in most cases, is the date of substantial completion of the fieldwork. It is usually not possible, however, to extend all procedures to the same date. If delivery of the examination report is unduly delayed, consideration should be given to extending the review to a later date.

The workpapers should contain specific information as to the scope of the investigation of subsequent events and the consideration given to each of them. Procedures related to subsequent events that extend into the subsequent period include, but are not necessarily limited to, the items described below. This review should include consideration of both quantitative and qualitative events and transactions.

	Performed By	Date
1. Review general journal entries for entries that would have a material effect on the financial statements as of the balance sheet date. Amounts over $_____ Date through _____		
2. Read minutes of meetings of directors, stockholders and important committees up to the report date. If minutes have not been prepared, obtain a written representation from the secretary about matters dealt with at such meetings. Review draft (if any) of proxy statement to be issued to shareholders for matters that may affect the financial statements.		
3. Read latest available interim financial statements. Compare them with the financial statements being reported on and obtain explanations for any unusual items noted as a result of the comparison. (Consider leveraging work previously performed by the department analyst, when possible.) Amounts over $_____ Date through _____		
4. Inquire of officers and other executives having responsibility for financial and accounting matters as to whether the interim financial statements have been prepared on the same basis as that used for the financial statements under examination. (Indicate identity of financial statements and periods covered.)		
5. Inquire of officers and other executives having responsibility for financial, accounting and strategic matters (limited, where appropriate, to major locations) as to: (Note: Indicate persons with whom discussions were held and date and attach memoranda or comments regarding significant matters discussed. Corporate office inquiries should extend to the report date.)		
a) Whether any substantial contingent liabilities or		

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commitments existed at the balance sheet date or at the date of inquiry.		
b) Whether there have been any legal matters raised against the company that would need to be considered for accrual or disclosure.		
c) Whether there were any significant changes in capital stock or debt to the date of inquiry.		
d) The current status of items in the financial statements being reported on was accounted for on the basis of tentative, preliminary or inconclusive data.		
e) Whether any other matters occurred that would materially affect the financial statements or operations of the company (including catastrophic losses). This includes appropriate inquiries as to subsequent events of material affiliates accounted for by the equity method.		
f) Whether the company is complying with the requirements set forth in *SSAP No. 9—Subsequent Events* with regard to the treatment of subsequent events.		
g) Whether the company has identified or become aware of any compliance issues with contracts, agreements, laws or regulations.		
h) Whether the company has become aware of any allegations, suspicions or actual instances of fraud.		
i) Whether the company's external or internal auditors have identified material issues that might impact the financial statements or have a significant impact on the organization's operations.		
j) Whether the company has had any material changes to the organizational structure, including significant changes to key management and the corporate governance structure, and if so, those changes could impact the organization's operations. Consider this in conjunction with any material changes identified through a review of the most recent company filings.		
k) Other inquiries related to prospective risks, which may include whether there have been changes in economic, market or regulatory conditions; changes in business strategy; loss of major customers; etc.		
6. If the above procedures produce responses that significantly affect the financial statements, they should be confirmed in writing. This may be done in the letter of representation.		

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EXHIBIT Q
REVIEW AND APPROVAL SUMMARY (RAS) FOR EXAMINATIONS

NAME OF COMPANY _____

EXAMINATION DATE _____

EXAMINER-IN-CHARGE _____

SUPERVISING EXAMINER _____

	Performed By	Date
Detailed Review (*usually performed by the examiner-in-charge*)		
1. I have read the Examination Planning Memorandum, risk matrices, and examination program insofar as they relate to the areas of the examination I reviewed.		
2. I have reviewed all workpapers and I am satisfied that the planned procedures were performed, results of work were adequately documented, and procedures performed were sufficient considering the results obtained and any changes in conditions occurring since the procedures were planned.		
3. I have verified that all known significant solvency risks have been addressed and each critical risk category has been appropriately considered.		
4. I have compared the accounts in the general ledger, trial balance or examination workpapers with the summarizations, classifications and descriptions of them in the annual financial statement.		
5. I am satisfied that the examination was conducted in accordance with appropriate professional standards, department policies and the procedures set forth in the *Financial Condition Examiners Handbook*.		
6. I have documented the results of the on-site examination and shared them with the assigned analyst. (Results may be documented through the use of Exhibit AA – Summary Review Memorandum (SRM). The SRM should include discussion of potential ongoing or future solvency concerns the insurer may face, the insurer's corporate governance and a summary, by branded risk classification, of examination adjustments, other examination findings, management letter comments and other residual risks or concerns the examiner may want to communicate to department personnel.)		
7. I have collaborated with the analyst in developing the prioritization level and supervisory plan.		

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General Review (*usually performed by the chief examiner or designee*)

1.	I have reviewed the Examination Planning Memorandum, risk matrices and examination program.	
2.	I have reviewed the workpapers for this examination and I am satisfied that the planned procedures were performed, results of work were adequately documented, procedures performed were sufficient, each known significant solvency risk was addressed and each critical risk category was appropriately considered.	
3.	I am satisfied that the examination was conducted in accordance with appropriate professional standards, department policies and the procedures set forth in the *Financial Condition Examiners Handbook*.	
4.	I have reviewed the documented results of the examination that were shared with the assigned analyst and I am satisfied that the examination results were adequately communicated.	
5.	I have reviewed the prioritization level and supervisory plan prepared or updated at the conclusion of the examination and concur with the results.	
6.	I have reviewed the Report of Examination and I am satisfied that it was prepared in conformity with statutory accounting principles as prescribed in the *Accounting Practices and Procedures Manual* or as permitted by the department.	

Note: Completion of procedures should be indicated by dating and initialing the space provided. Any exceptions (e.g., Not Applicable) should be explained either in this RAS or in an attached memorandum.

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EXHIBIT R
SUGGESTED MINIMUM AMOUNTS OF FIDELITY INSURANCE

Fidelity bonds provide coverage to the insured business or individual for money or other property lost because of dishonest acts of its bonded employees. While the need for fidelity bond coverage can vary from company to company, it is recommended that those who have access to cash and investments be bonded. This includes the people who have the ability to authorize wire transfers, write checks and those who can buy, sell, or transfer investments. The terms of each policy may vary, however; it is recommended that the policy be written to cover material acts of theft or dishonesty by bonded employees.

The following table indicates the exposure index amount with the recommended fidelity bond amount.

Exposure Index			Bracket No.	Amount of Bond		
$1,000	-	$25,000	1	$15,000	-	$25,000
25,000	-	125,000	2	25,000	-	50,000
125,000	-	250,000	3	50,000	-	75,000
250,000	-	500,000	4	75,000	-	100,000
500,000	-	750,000	5	100,000	-	125,000
750,000	-	1,000,000	6	125,000	-	150,000
1,000,000	-	1,375,000	7	150,000	-	175,000
1,375,000	-	1,750,000	8	175,000	-	200,000
1,750,000	-	2,125,000	9	200,000	-	225,000
2,125,000	-	2,500,000	10	225,000	-	250,000
2,500,000	-	3,325,000	11	250,000	-	300,000
3,325,000	-	4,175,000	12	300,000	-	350,000
4,175,000	-	5,000,000	13	350,000	-	400,000
5,000,000	-	6,075,000	14	400,000	-	450,000
6,075,000	-	7,150,000	15	450,000	-	500,000
7,150,000	-	9,275,000	16	500,000	-	600,000
9,275,000	-	11,425,000	17	600,000	-	700,000
11,425,000	-	15,000,000	18	700,000	-	800,000
15,000,000	-	20,000,000	19	800,000	-	900,000
20,000,000	-	25,000,000	20	900,000	-	1,000,000
25,000,000	-	50,000,000	21	1,000,000	-	1,250,000
50,000,000	-	87,500,000	22	1,250,000	-	1,500,000
87,500,000	-	125,000,000	23	1,500,000	-	1,750,000
125,000,000	-	187,500,000	24	1,750,000	-	2,000,000
187,500,000	-	250,000,000	25	2,000,000	-	2,250,000
250,000,000	-	333,325,000	26	2,250,000	-	2,500,000
333,325,000	-	500,000,000	27	2,500,000	-	3,000,000
500,000,000	-	750,000,000	28	3,000,000	-	3,500,000
750,000,000	-	1,000,000,000	29	3,500,000	-	4,000,000
1,000,000,000	-	1,250,000,000	30	4,000,000	-	4,500,000
1,250,000,000	-	1,500,000,000	31	4,500,000	-	5,000,000

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Calculation of Bond Amount

1. Total Admitted Assets

   $_____ X 5% = $_____

2. Gross Income*

   $_____ X 10% = $_____

   Exposure Index = $_____**

3. Minimum Amount of Bond

   Bracket No._____ $ _____

*Include gross premium written and assumed plus interest and dividend income.

**Amount is calculated by adding the results of number 1 and 2 above.

The exposure index is calculated using all insured companies named on the fidelity bond. The fidelity bond policy limits listed above are not a substitute for the risk assessment that should be made by company management in establishing a reasonable level of insurance coverage. Similarly, company management should evaluate its business needs for other insurance coverages such as general liability and property, if applicable.

In evaluating the amount of the fidelity bond coverage amount, the examiner should not rely on the schedule above as an absolute guide, but instead, should review the internal controls that serve to mitigate the exposures covered by such insurance policies. In evaluating the fidelity bond, the examiner should also consider if the reporting entity has the ability to meet the deductible.

Note: Fidelity bonds are written to cover material acts of theft or dishonesty by bonded employees. Thus, if a crime is committed by an employee who is not bonded, the company may have to bear the costs of that loss. Alternatively, companies may buy a general fidelity insurance policy commonly referred to as crime coverage. Crime coverage is an acceptable alternative to fidelity bonds if it provides coverage that is at least as broad as the coverage provided by a fidelity bond. Keep in mind that both fidelity bonds and crime coverage will vary from policy to policy, so the examiner should use professional judgment when analyzing the individual policy and the risk that the policy hedges.

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EXHIBIT S
EXAMINER'S AFFIDAVIT AS TO STANDARDS AND PROCEDURES USED IN AN EXAMINATION

State of _____,

County of _____,

_____, being duly sworn, states as follows:

1. I have authority to represent _____ in the examination of _____.

2. _____ is accredited under the National Association of Insurance Commissioners Financial Regulation Standards and Accreditation.

3. I have reviewed the examination work papers and examination report, and the examination of _____ was performed in a manner consistent with the standards and procedures required by _____.

The affiant says nothing further.

_____
Examiner's Signature

Subscribed and sworn before me by _____ on this _____ day of _____, 20_____.

(SEAL)

_____
Notary Public

My commission expires _____ [date].

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EXHIBIT T
SAMPLE LETTER OF REPRESENTATION

An illustrative management representation letter is presented in Exhibit T. The sample letter incorporates common representations that might be obtained by the examiner. The management representation letter should be customized by the regulator to meet the circumstances of the particular examination and the nature of the company being examined.

Modifications or special representations relating to management's knowledge or intent should be obtained when the examiner believes that they are necessary to complement other examination procedures or when corroborating evidential matter is limited. It is generally expected that representations be obtained only for specific areas of risk that are considered as part of the examination. Representations may be quantitative or qualitative in nature and should align with the purpose of risk-focused examinations. It would be unusual to draft a representation letter that does not include some special representations to cover individual company circumstances.

Certain representations may be limited to matters that may have a material effect on the statutory financial statements, as indicated in the illustrative letter. It is preferable for management to specify the agreed-upon materiality limits in the representation letter. Illustrative language for this materiality purpose is included in the sample letter. When evaluating the materiality threshold to be included in the letter, the examiner should consider the nature of the company under examination and the extent of detail desired in management's representations. In no event shall the materiality threshold included in the letter exceed planning materiality levels, as this level relates to the examiner's overall perspective of the financial statements, rather than a particular account balance or cycle. The illustrative letter also contains qualitative criterion of materiality, which is required in all representation letters.

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(On Company Letterhead)

Date *(date should agree with report of examination)*

Name of Examiner
Examiner-In-Charge
(Name of State) Department of Insurance
Address
City, State ZIP Code

We are providing this letter in connection with your examination of the statutory financial statements and financial condition of *(Name of Insurance Company, Title Company or Mortgage Guaranty*) as of (*Month, Date, Year*) and for the period from (*Month, Date, Year*) to (*Month, Date, Year*). We are responsible for the fair presentation of the statutory statements of financial position, results of operations and changes in statutory financial position in conformity with the accounting practices prescribed or permitted by the *(Name of State)* Department of Insurance. We are also responsible for the completeness and accuracy of qualitative assertions made to you during the course of the examination.

Certain representations in this letter are described as being limited to those matters that are material. Solely for the purpose of preparing this letter, the term "material," when used in this letter, means any item or group of similar items involving potential amounts of more than $_____. These amounts are not intended to represent the materiality threshold for financial reporting and disclosure purposes. Notwithstanding this, an item is considered material, regardless of size, if it involves an omission or misstatement of accounting information that, in the light of surrounding circumstances, makes it probable that the judgment of a reasonable person relying on the information would have been changed or influenced by the omission or misstatement.

We confirm, to the best of our knowledge and belief, the following representations made to you during the examination.

1. Access to Documents and Company Personnel
   - We have responded fully to all inquiries made to us by you during the examination.
   - We have made available to you all:
     - Statutory financial records and related data.
     - Minutes of meetings of stockholders/policyholders *(if a mutual company)*, directors and committees, or summaries of actions of recent meetings for which minutes have not yet been prepared.
     - Access to individuals within the company from whom you have requested examination evidence.
     - Risk assessment documentation.

2. Corporate Governance Practices
   The corporate governance practices and policies that the company has in place are adequate and appropriate in relation to the size and complexity of the company and the systems and processes used are adequate and appropriate to address risk inherent within the company.

3. Significant Risk Areas
   We confirm the completeness of the information provided to you in relation to the significant risks identified by the company, the risk mitigation processes/strategies utilized by the company, supporting documentation and other evidence for all of following:
   - The investment strategy of the company, the listing of complex or subjectively valued investment holdings, existing or potential impairments of invested assets and the near-term cash flow needs of the company.
   - The reinsurance strategy of the company, listing of all reinsurance agreements, types of coverage in place, associated limits, net retentions, transfer of risk, any concentration of reinsurance assumed or ceded, coverage periods and the accounting/disclosure of reinsurance balances reported.
   - The underwriting, pricing and marketing practices of the company, underwriting guidelines, risk exposure limits, rates and expense structure, distribution channels and the underlying data on all policies in force.

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- The reserve assumptions and methodologies utilized by the company, calculations of significant reserves, underlying claims data for all reserves and related expenses reported and incurred but not reported, and the accounting/disclosure of reserve balances reported.
- The identification of all related parties and any relationships, agreements (either written or oral) and transactions with related parties. We confirm that there are no side agreements or other arrangements (either written or oral) that have not been disclosed to you.
- The capital management practices utilized by the company and the accounting/disclosure of capital and surplus balances reported.

4. Financial Statements/Reporting
   - The financial statements filed with your Department are free of material misstatements.
   - We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.
   - There are no material transactions that have not been properly recorded in the accounting records underlying the statutory financial statements.
   - All required returns and statutory reporting requirements have been filed on a timely basis with the appropriate regulatory bodies.
   - The company has recorded and disclosed subsequent events in accordance with SSAP No. 9—Subsequent Events. (In the event of a subsequent event, the following should replace this clause in the Management Representations Letter: Other than … described in Note X to the financial statements, there have been no events subsequent to period end which require adjustment or disclosure in the financial statements or notes thereto.)

5. Fraud
   There have been no:
   - Fraud or other irregularities involving management or employees who have significant roles in the risk management process or internal control structure.
   - Fraud or other irregularities involving other employees that have, or may have, a material effect on the statutory financial statements.
   - Fraud or other irregularities involving agents, MGAs, third-party administrators, independent contractors, holding companies or other individuals or parties that have, or may have, a material effect on the statutory financial position of the company.
   - Communications from regulatory agencies concerning noncompliance with, or deficiencies in, statutory financial reporting practices since the last examination.

6. Information Systems
   - Regarding the corporate information systems (IS) function, we have made available to you all information and documentation responsive to your review of the IS function; and we have, to the best of our knowledge and belief, answered all questions and inquires fully and accurately.
   - Except as already disclosed to you, the corporate IS function has established and maintains adequate policies, procedures and guidelines concerning systems security, systems back-up, systems design, change controls, testing of system changes, configuration of transaction controls, documentation and error or exception reporting.
   - All corporate IS policies, guidelines and systems that could have a material impact on the financial solvency of the company are monitored and have been complied with, and no breaches, whether perpetrated by external or internal parties, are known to have occurred. (If incorrect, describe fully.)
   - There were no significant deficiencies or material weaknesses with new systems, system modifications or new site locations implemented during the period that could have a material impact on the financial solvency of the company.
   - None of the company's third-party service providers, upon which the company relies, has known problems that would be likely to threaten the reliability of the company's information systems and/or the systems' internal controls, or that could have a material impact on the company's financial solvency.

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7. Contingent Liabilities

- We have properly disclosed all pending changes in the organization structure, financing arrangements or other matters that could have a material effect on the statutory financial statements or negatively impact the financial solvency of the company.

- There are no other liabilities or gain or loss contingencies that are required to be accrued or disclosed by SSAP No. 5—*Liabilities, Contingencies and Impairments of Assets*.

- There is no litigation against the company that is considered material in relation to the statutory financial position of the company. For purposes of this section, the company has excluded litigation for which the only amounts sought relate to benefits within the normal terms of coverage under contracts of insurance issued by the company, and which are otherwise considered in the actuarial determination of the company's unpaid claim reserves.

- (In the occurrence of a contingent liability noted by management, the following should be included in the management representation letter.) Except for the contingent liability disclosed in Note X of the financial statements, there are no contingent liabilities that require disclosure in the financial statements or notes thereto.

- *(If applicable*) The … litigation by XYZ Company has been settled for the total sum of $XXX and has been properly reflected in the financial statements. No other claims in connection with litigation have been, or are expected to be, received.

8. Compliance

- There are no violations or possible violations of laws or regulations whose effects should be considered for disclosure in the statutory financial statements or as a basis for recording a loss contingency.

- The company is not aware of the employment of or a business relationship with a "prohibited person" as defined in The Violent Crime Control and Law Enforcement Act of 1994: United States Code, Section 1033 (e)(1)(A).

- We have complied with all regulatory requirements, federal and state laws, applicable Statements of Statutory Accounting Principles, and Annual Statement Instructions which could materially affect the statutory financial statements in the event of non-compliance.

- We have complied with all provisions of contractual agreements that could have a material effect on the statutory financial statements or negatively impact the financial solvency of the company in the event of non-compliance.

- We have disclosed to you any events of non-compliance that could negatively impact the financial solvency of the company.

We understand that your examination was made in accordance with standards established by the (*Name of State)* Department of Insurance and procedures established by the National Association of Insurance Commissioners, and accordingly included review and testing of the accounting records and other procedures as considered necessary under the circumstances.

Name of Insurance Company, Title Company or Mortgage Guaranty Company

_____ _____

Chief Executive Officer Date

_____ _____

Chief Financial Officer Date

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EXHIBIT U
SUPERVISORY PLAN EXAMPLE TEMPLATE

A Supervisory Plan should be developed by the domestic state for each domestic insurer at least once a year. The Supervisory Plan should be concise and outline the type of surveillance planned, the resources dedicated to oversight, and the coordination with other states. A proposed outline of a Supervisory Plan is provided below; however, the actual form and content should be determined by each respective state. Each state should determine how it will allocate its resources to create and maintain the Supervisory Plan document. Regardless of who creates and maintains the document, the document should be kept confidential but available for the review of all internal departments upon request.

SUPERVISORY PLAN

XXXXXXX Insurance Company Lead State: _____

RBC Ratio (CY):
RBC Ratio (PY):
Department Designation:
Defined as Troubled Company (Y/N)?
Multi-State License Status (Y/N)?
Contact at Company: _____ Phone: _____

Date Prepared: xx/xx/xxxx

Background: *(Initially discuss prior period surveillance planned, the resources dedicated to the oversight, and the coordination with other states. Prior problem areas, if applicable, such as solvency issues, corporate governance, market conduct problems, etc should be included.)*

Current Plan Overview: *(Discussion should include assessed prioritization of the company and recent changes thereto, current concerns, high risk areas, changes in risk profile and management, current assessment of management strengths and weaknesses relative to corporate governance and risk management, etc.)*

Financial Analysis Monitoring

Planned Meetings with Management

Examinations

- Limited-Scope Examinations
- Full-Scope Examinations
- Resources
- Staffing
- Coordination with Other States

Other

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EXHIBIT V – OVERARCHING PROSPECTIVE RISK ASSESSMENT

Background

The concept of risk on a risk-focused examination encompasses not only risks as of the examination date, but also risks that extend or commence during the time in which the examination was conducted, as well as risks that are anticipated to arise or extend past the point of examination completion. As such, consideration of "prospective risks" (including moderate or high residual risks existing at the balance sheet date that will impact future operations, risks anticipated to arise due to assessments of company management and/or operations, or risks associated with future business plans of the company) is an intrinsic element of a risk-focused examination and should occur throughout all phases of the examination process.

Use of this Exhibit

In completing this exhibit and documenting the examiner's consideration of prospective risks throughout the examination process, the examiner should conduct an evaluation and, if possible, conduct examination procedures on the noted prospective insolvency risks to assess the degree of risk present and recommend future monitoring. Throughout the examination process and at the conclusion of the exam, the examiner should communicate with the department's financial analysts to keep them informed of the identified prospective risks and examiner assessments. The branded risk classifications should be used to summarize prospective risks identified for communication to the analyst and this communication should include details obtained during the examination that will enhance the ongoing monitoring of the company.

In conducting examinations of insurers that are part of a holding company group, it is important to note that many critical prospective risks may occur at the holding company level. The exam team should seek to coordinate the identification and assessment of prospective risk in accordance with the exam coordination framework and lead state approach outlined in Section 1 of this Handbook. Where possible, in a coordinated examination, the lead state's work on prospective risk should be utilized to prevent duplication of effort and to leverage examination efficiencies.

As discussed throughout this Handbook guidance, the consideration of prospective risks should occur throughout each phase of the examination process. If the examiner identifies a prospective risk that relates to one specific key activity of the company, this prospective risk should be documented in the corresponding risk matrix for that key activity and treated similarly to other identified risks. However, if the examiner identifies an overarching prospective risk (a prospective risk that does not relate to a specific key activity identified, or relates to more than one key activity identified), the examiner should utilize this exhibit to document the process to consider these overarching prospective risks.

By the end of Phase 1, the examiner should have a preliminary listing of overarching prospective risks included on Exhibit V – Overarching Prospective Risk Assessment. By the end of Phase 2, the list of risks on Exhibit V should be updated to include all significant overarching prospective risks identified on Exhibit CC – Issue/Risk Tracking Template.

Prospective risks may continue to be identified beyond Phase 1 and Phase 2, but all significant overarching prospective risks identified during later phases of the exam should continue to be documented and investigated on Exhibit V, regardless of the phase in which the risk was identified.

All of the instructions for investigating prospective risks on Exhibit V should be completed by the end of Phase 5. It is not required that the various steps to investigate prospective risks on Exhibit V directly coincide with the seven-phase exam approach, but it is recommended that examiners complete each step of Exhibit V as early in the exam as practical to ensure each risk identified is sufficiently tested and reviewed.

Exhibit V – Part One – Overarching Prospective Risk Testing Template

Examiners should use this worksheet to document a review and testing of overarching prospective risks throughout the examination. Examiners may also use the examples provided on the template as a guide to assist in determining the nature and extent of the prospective risk review to be performed. **Please Note:** The risk mitigation strategies identified in the template are only examples, and the examiner should be aware that the insurer might use other strategies to mitigate the

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identified risk. Instructions for completing and documenting a review of prospective risk within the template are as follows:

Template Column	Instructions for Completing
Overarching Prospective Risk Identified	Based on the knowledge and understanding of the company obtained during the planning stages of the exam, document any overarching prospective risks identified.
Branded Risk Classification	For each identified risk, document the associated branded risk classification(s) from the following list: Credit (CR), Legal (LG), Liquidity (LQ), Market (MK), Operational (OP), Pricing/Underwriting (PR/UW), Reputation (RP), Reserving (RV), and Strategic (ST).
Risk Mitigation Strategies	Identify risk mitigation strategies in place at the insurer (if any) to address the prospective risk.
Corroborating Evidence and Documentation	Provide corroborating evidence and documentation supporting the risk mitigation strategy. Attach and reference supporting workpapers.
Prospective Risk Assessment	Using professional judgment, determine the appropriate prospective risk level (High, Moderate or Low) after considering the nature of the risk and the company's mitigation strategies. Provide a brief explanation regarding the prospective risk level determined.
Ongoing Examination Procedures and Follow-Up	Document any additional procedures deemed necessary to be performed to further understand or address the risk. Describe the plan for follow-up, such as specific procedures for continual monitoring, communication with the analyst, limited-scope examinations, revisions to the Supervisory Plan or Insurer Profile Summary, etc.

Exhibit V, Part Two – Common Areas of Concern

Examiners should use this as a reference guide to assist in identifying categories of prospective risk that may be relevant for review and inclusion on the Exhibit V, Part One.

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PART ONE – OVERARCHING PROSPECTIVE RISK TESTING TEMPLATE

Overarching Prospective Risk Identified	Branched Risk	Risk Mitigation Strategies	Corroborating Evidence and Documentation	Prospective Risk Assessment	Ongoing Examination Procedures and Follow-Up
Example Prospective Risk 1: The company's executive compensation practices encourage and/or reward excessive risk-taking and may induce fraudulent behavior.	OP	The board of directors maintains an independent compensation committee that meets at least annually to update the strategy and approve executive compensation. Variable compensation is limited to a percentage of salary and is based on qualitative and quantitative performance over a rolling 5-year period.	Reviewed minutes of the 20XX compensation committee meeting (see A.1.1), noting that actions were taken as described by the company. Obtained and reviewed variable compensation plan (see A.1.2), noting cap as a percentage of salary. Reviewed schedule calculating 20XX variable compensation for executives (see A.1.3), noting the calculation is based on five-year results and ties to GAAP.	Although the company carries a high expense ratio and the department had identified concerns with compensation in the past, it appears that the company has put additional controls in place to mitigate risks relating to executive compensation. As such, a **Moderate** prospective risk rating is deemed appropriate.	Based on the moderate prospective risk rating, total compensation awarded to the top five executives in the company was benchmarked to competitors and industry averages (see A.1.4). Although the company appears to be on the high end of the range, compensation did not appear unreasonable. Analyst will be asked to closely monitor changes in the expense ratio and executive compensation to determine if additional action is necessary.
Example Prospective Risk 2: The company may experience rating agency downgrades, causing the company to be unable to sell its products.	ST RP	The company has processes in place to monitor and manage its financial performance in accordance with metrics considered significant by rating agencies. The company utilizes modeling to determine its economic and rating agency capital needs.	Reviewed financial reports for evidence of monitoring of rating agency performance measures and management review, noting that the company appears to be meeting its benchmarks w/o/e (see A.1.4). Obtained and reviewed the economic capital calculation at 12/31/XX, noting that rating agency considerations are included in the process	The company has product lines sensitive to a ratings decrease; however, it appears that the company has appropriate controls and strategies in place to maintain strong ratings. As such, **Low** prospective risk is deemed appropriate.	Based on the low prospective risk, no additional work is necessary at this time. However, we request that the analyst notify the examination unit if a future rating downgrade occurs so that the units can collaborate regarding actions to be taken (e.g., limited scope exam) at that time.

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Overarching Prospective Risk Identified	Branded Risk	Risk Mitigation Strategies	Corroborating Evidence and Documentation	Prospective Risk Assessment	Ongoing Examination Procedures and Follow-Up
			and that the company appears to hold capital in excess of the calculated amount. See A.1.5 for more information.		
Example Prospective Risk 3: The company has not fully evaluated the impacts of health reform and taken steps to ensure its strategy will account for changes mandated by new legislation.	LO ST	The company has developed management reports to analyze financial indicators by product line. These reports are reviewed by the CFO and CEO on a monthly basis. The company monitors the current requirements and will implement change as necessary.	Reviewed reports, which provide only limited data and no analysis describing how health reform may affect future financial performance (see A.1.6). There is no evidence of a strategic plan that incorporates compliance with applicable requirements or plans for implementing future requirements.	Limited resources have been set aside to handle the impact of health reform on the multiple lines of health business the company writes. As such, a **High** prospective risk rating is deemed appropriate.	Recommend that the company quantify the effect of health reform on different lines of business as well as the resources needed to be in compliance. This information should be compiled into a summary showing future projections that can be provided to the analyst. The analyst is asked to work with the Company to obtain the projections addressing health reform provisions and review these projections for reasonableness and the impact on the Company's future solvency.
Example Prospective Risk 4: The company is not performing sufficient research and due diligence in developing, marketing and pricing new	PR/UW	Company analysts perform significant research regarding current market conditions and demands, product mix and profitability, and other product/market characteristics on a regular basis. Reports summarizing the findings are generated monthly. The company has a group of individuals from departments across the company (legal, actuarial, marketing, financial,	Reviewed the monthly market conditions report, noting that the company has compiled detailed industry information regarding similar products and pricing, market demand, customer location, etc. (see A.2.1). Reviewed the	Although the company is constantly releasing significant new products into the market, it has significant oversight of and experience with product	Based on the low prospective risk and the history of successful product launches, no additional work is necessary at this time. The analyst will be asked to monitor financial ratios related to new lines of business and report

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Overarching Prospective Risk Identified	Branded Risk	Risk Mitigation Strategies	Corroborating Evidence and Documentation	Prospective Risk Assessment	Ongoing Examination Procedures and Follow-Up
products		etc.) that compose an ad-hoc group specifically charged with product development. This group has significant experience in developing, marketing and pricing new products. Issuance of new products requires input and approval from the board of directors. The board has a special subcommittee that meets on a quarterly basis to discuss company strategy and new product development	qualifications and background of the employees within the product development "team," noting that all members have extensive experience in the many aspects of product development. Further, noted that this group maintains a manual (or action plan), approved by the board of directors, which details key procedures and areas of research necessary for product development, as well as a description of the various levels of review that occur throughout the product development process (see A.2.3). Obtained meeting minutes from the committee of the board of directors evidencing discussion of potential new products considerations for pricing, and board approval for the issuance of the new product (see A.2.2).	development. The company has well-established and effective risk mitigation strategies in place. Based on such, a **Low** prospective risk is deemed appropriate at this time.	any significant deviations to the exam unit.

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PART TWO – COMMON AREAS OF CONCERN

The prospective risk categories provided within this exhibit are not designed to be an all-inclusive list and might not apply to all insurance companies under examination. The examiner's understanding of the company obtained in Phase 1, including a review of the company's Enterprise Risk Report (Form F), should be utilized to determine whether risks in these categories might be applicable to the company. The company will likely face additional prospective risks that do not fit within the categories in this exhibit.

Prospective Risk Category	Comments
Merger and Acquisition Activity	If applicable, review the company's process to identify and perform due diligence on potential acquisitions. In addition, consider reviewing the company's process to integrate acquired entities and business into its systems.
Product Development	If applicable, review and assess the company's process to identify, develop, price and market new products in accordance with the company's strategy and business needs.
Legal and Regulatory Changes	If applicable, review how the company identifies, monitors and addresses changes to the legal and regulatory environment it operates within. For example, review the company's processes in place to analyze the impact that health care reform could have on the company, including support for company projections and strategies for appropriateness.
HR/Personnel Risks	If applicable, review and assess the company's HR processes to identify, mitigate and monitor risks related personnel management (including succession planning for critical positions) as well as hiring, managing, retaining and terminating personnel in accordance with company needs.
Strategic Planning	If applicable, review and assess the company's processes for strategic planning to determine whether the company regularly analyzes its strengths and weaknesses, as well as opportunities and threats, on an ongoing basis. In addition, it might be appropriate to review the company's process to update its overall business plan on a regular basis.
Compensation Structure	If applicable, review the company's process for developing, monitoring and adjusting its compensation structure to ensure that employees are appropriately compensated without creating an incentive to misrepresent financial results.
Rating Agency Downgrade	If applicable, review the company's process to monitor and prepare for potential adverse changes in its credit ratings. If a future rating agency downgrade is deemed likely, consider whether the company is adequately prepared to handle the results of such a downgrade.
Costs of Capital	If applicable, review the company's access and ability to obtain capital, reinsurance and letters of credit, if necessary, to meet funding and risk diversification needs.
Business Continuity	If applicable, review the company's business continuity plan. Follow the steps outlined in Section 1, Part III.
Climate Change	If applicable, review the company's process for identifying and monitoring risks resulting directly or indirectly from the impact of climate change risk.

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EXHIBIT Y
EXAMINATION INTERVIEWS

Overview

Interviews are a useful examination tool to gather information about key activities, risks and risk mitigation strategies. Employees can also provide information on fraudulent activity within the company. It is critical for the examination team to understand and leverage the company's risk management program; i.e., how the company identifies, controls, monitors, evaluates and responds to its risks. The discipline and structure of risk management programs vary dramatically from company to company. Interviews should be performed in the early stages of the examination so that regulators can adjust their procedures accordingly. An examiner can perform alternate, additional or fewer detail and control tests as a result of interviews with the company.

Interviews should be conducted with key members within management of the company, as well as members of the board of directors, audit committee, internal/external auditors and any other employees deemed necessary. These interviews can be used at the beginning of the examination or at any time during the examination as necessary. However, a basic understanding of the company is essential to obtain prior to conducting interviews. Examiners should consider the size and complexity of the organization in determining which individuals to interview. The interview process is a key step in the "top–down" approach, beginning with senior management and then drilling down through the various levels of management to obtain a thorough understanding of the organization to assist in scoping the examination. In order to select the individuals to interview, the examiners should obtain an organizational chart from the company and compile a list of potential interviewees. Interviews of board members and senior company management should be conducted by examiners who possess the appropriate background and training.

Interviews should be performed in person, if possible. This allows the interviewer to receive both verbal and nonverbal communication. The interviews should be kept confidential when possible; however, if a significant fraud or other pertinent issue was discovered through the interviews, the regulator has a duty to report the conflict to the appropriate officials.

The examiner should conduct the interview in a location where both parties are free to talk openly. The examiner should ask relevant questions, with the most general questions posed first as building blocks for additional conversation. The examiner may want to consider alternating between open-ended questions (e.g., "Explain to me how this process works.") vs. closed-ended questions (e.g., "How many claim processors do you have in your department?") to obtain the information. Open-ended questions are generally better suited for explanation and processes, while closed-ended questions are better suited to obtain concise information. The examiner should be prepared, listen carefully and focus on the speaker's entire message, as well as the non-verbal cues expressed during the interview process.

Significant risks and concerns identified through completion of the examination interviews should be adequately addressed within the examination workpapers. As such, all significant risks identified by the examiner during the interview process should be recorded in a central location for tracking purposes, such as Exhibit CC – Issue/Risk Tracking Template or a similar document.

Because information obtained from the interview serves as important evidence in the examination process, the examiner should develop techniques to plan, conduct, document and consider interview information. Although interviews play a key role in gaining useful insight into company operations, interviews alone are not sufficient exam evidence and should be corroborated with other exam documentation to evaluate the accuracy of the information.

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NOTE: The following template was prepared to assist examiners in obtaining a general knowledge of the company through the interview process. The examiner performing the interview should not rely exclusively on this template and should tailor questions based on knowledge of the company and the interviewee. Each section of the template is described below to assist the examiner in tailoring the template to the interviewee.

Interviewer: _____ ***Interviewee:*** _____

Instructions

Experience and Background – In this section, the examiner should determine the knowledge, education and practical experience the interviewee possesses. When obtaining background information on board/committee members, the examiner should consider whether the interviewee is independent of the company. If the examiner has obtained sufficient information from the interviewee's biography, questioning may not be necessary.

Duties and Responsibilities – In this section, the examiner should obtain information about what responsibilities the interviewee has within the organization, including any potential conflicting duties. When interviewing board/committee members, the examiner should determine whether the interviewee demonstrates a proper understanding of how management establishes and monitors achievement of objectives. In addition, board members should be able to explain what types of company information they monitor on a continuing basis.

Reporting Structure – In the reporting section, the examiner should gain an understanding of the organizational structure and how the interviewee's department interrelates with other departments. Examiners should obtain information on who reports to the interviewee, as well as to whom the interviewee reports, what type of information is reported and reviewed, and how often the information is reported and reviewed.

Ethics – In the ethics section, the examiner should obtain information explaining how ethics are communicated and expressed throughout the company. The examiner also should determine if the interviewee is aware of any fraudulent activities or allegations of fraudulent activities impacting the company. When interviewing board members, the examiner should determine whether the board is reviewing and enforcing the code of conduct on a continuing basis.

Risk Areas – In this section, the examiner should ask the interviewee to explain the risks inherent in his/her department or area of interest. Inquiring about risks will assist the examiner in completing Phase 2, Identify and Assess Inherent Risk in Activities. In addition to interviewing board members and upper management about risks inherent to the company, the examiner should also obtain information regarding types of external/environmental factors affecting the company.

Risk Mitigation Strategies – In this section, the examiner should ask the interviewee to explain how the company mitigates risks identified in the previous section. This information should include what types of controls are in place to prevent or detect those risks. Inquiring about risk mitigation strategies will assist the examiner in Phase 3, Identify and Evaluate Risk Mitigation Strategies (controls).

Corporate Strategy – This section only pertains to board/committee members and upper management. The examiner should ask the interviewee to explain the corporate strategic initiatives of the company. In addition, the examiner should determine how the company prepares strategic plans for the future of the company and what competitive advantages/disadvantages exist within the company.

Other Topics – In this section, the examiner should obtain information regarding any other topics not previously discussed. Some topics include significant turnover in the interviewee's department, political or regulatory changes that may affect current and prospective risks.

Conclusion – In this section, the examiner should document any concerns related to the suitability of the individual members of management for their assigned roles and responsibilities.

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Examination Interview Template

Experience and Background

Duties and Responsibilities

Reporting Structure

Ethics

Risk Areas

Risk Mitigation Strategies (Internal Controls)

Corporate Strategy

Other Topics

NOTE: The following lists of questions represent optional tools for examiners to use when conducting examination interviews. Lists have been created for several key positions of the company that are commonly interviewed during the examination process. Each list includes questions that have been customized based on the company position that examiners may consider asking during the interview. It is important to note that the actual questions asked during the examination interview process should be at the discretion of the interviewer. **Not all questions included in the listing may be appropriate for each interview. In addition, the interviewer should ask questions not included in the listing, according to the examiner's understanding of the company.**

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Sample Interview Questions for Board or Committee Members

Experience and Background

- How has your professional experience and background prepared you to serve on the board of directors for this company?

Duties and Responsibilities

- How often does the board/committee meet? Why is that sufficient?
- Briefly describe your duties and responsibilities, including what types of company information you monitor on a continuous basis.
- How does management establish objectives and how does the board of directors monitor achievement of those objectives?
- What role does the board of directors play in determining executive compensation?
- What areas are discussed and what type of decisions are made by the board/committee?
  - How does the board ensure that sufficient information is received to make informed decisions on behalf of the company?
- Does the board/committee review related-party transactions?
- What role does the board/committee play in overseeing the actuarial function as well as associated internal controls?

Reporting Structure

- Describe the reporting structure of the company, including who reports to the board/committee.
- Describe the interaction the board of directors has with the internal/external auditors, shareholders and senior management.

Ethics

- Does the company have a code of conduct/ethics in place? Is it enforced? Approved?
- Explain the commitment to ethics by the board/committee and explain how the board/committee conveys that commitment to employees.
  - How does the board obtain an understanding of the "tone" throughout the organization?
- How does the company compare to others, in terms of its position on ethics?
- Do you have any knowledge or suspicion of fraud within the company?

Risk Areas

- How does the board identify and monitor key risks faced by the company?
  - What are the key risks the board has identified?
  - What are the key prospective risks the company faces?
- Does the board review any type of stress testing?

Risk Mitigation Strategies (Internal Controls)

- How often does the board receive reports from management on the internal controls of the company?
  - What information is reported?

Corporate Strategy

- How is the board involved in significant corporate strategy decisions?
- Does the board approve an annual business plan?
- How does the board gain comfort with total exposures and the risk/return trade-offs?
- Where is the company headed strategically? What type of plan is in place to implement this strategy? Has it been approved? How is it being monitored?
- Is the corporate strategy effectively communicated between senior management and the rest of the company?
- Explain any strengths or weaknesses of the company, as well as opportunities or threats, the company is facing and how the company is responding to each.

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- If part of a holding company:
  - How does the holding company contribute to the company's strategy?
- How might the holding company be impacted by the company's strategy?

Other Topics

- Explain any significant turnover in senior management or on the board/committee.
- What type of succession planning does the company have in place?
- Based on the current economic climate, are there any other competencies/skills that would be useful to the board?
- Is the current size of the board sufficient to fulfill necessary oversight responsibilities?
- How does the company monitor and assess financing needs, as well as access to capital?
- How does the company monitor, assess and respond to information security risks (including those related to cybersecurity threats)?

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Sample Interview Questions for the Chief Executive Officer

Experience and Background

- How has your professional experience and background prepared you to serve as the Chief Executive Officer for this company?

Duties and Responsibilities

- Briefly describe your duties and responsibilities.
- How does management establish objectives and how is the achievement of those objectives monitored?
- What role do you play in the hiring of senior management and determining executive compensation?
  - How is your compensation determined?
- How do you support the operations and administration of the board?
- Briefly describe your oversight responsibilities regarding the company's actuarial function?

Reporting Structure

- Describe the reporting structure of the company, including to whom you report as well as those reporting to you.
- Explain the function and reporting structure of your senior management team.
  - How often are you in contact with them?
- Describe your interaction with the board of directors.

Ethics

- Does the company have a code of conduct/ethics in place? Is it enforced? Approved?
- Explain management's commitment to ethics and explain how management conveys that commitment to employees.
  - How does management obtain an understanding of the "tone" throughout the organization?
- When establishing ethics, does the company evaluate what other companies have implemented? If yes, how does the company compare?
- Do you have any knowledge or suspicion of fraud within the company?

Risk Areas

- How are key risks faced by the company identified and monitored?
  - What are the key prospective risks the company faces?
  - How are these risks communicated to senior management and throughout the company?
- Describe any stress testing performed by the company.

Risk Mitigation Strategies (Internal Controls)

- What is the formal procedure for reporting on risk management to senior management and the board?
- Explain your commitment to the internal control structure.
- What is your company's plan for operating in crisis/disaster – business continuity?
- From a strategic perspective, how are risks addressed across all business units and entities?

Corporate Strategy

- Where is the company headed strategically? What type of plan is in place to implement this strategy? Has it been approved? How is it being monitored?
- What are your plans for retaining and growing business?
- Explain what types of tools and/or reports you utilize to make key business decisions.
- Explain any strengths or weaknesses of the company, as well as opportunities or threats, the company is facing and how the company is responding to each.
- What key measures do you assess to evaluate the company's performance and competitive position?
- If part of a holding company:
  - How does the holding company contribute to the company's strategy?
  - How might the holding company be impacted by the company's strategy?

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- How often do you discuss corporate strategy with your direct reports?

Other Topics

- Explain any significant turnover in senior management and/or on the board/committee.
- What type of succession planning does the company have in place?
- How does the company monitor and assess financing needs, as well as access to capital?
- How does the company monitor, assess and respond to information security risks (including those related to cybersecurity threats)?

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Sample Interview Questions for the Chief Financial Officer/Controller

Experience and Background

- How has your professional experience and background prepared you to serve as Chief Financial Officer for this company?

Duties and Responsibilities

- Briefly describe your duties and responsibilities, including the preparation and information flow of financial reports.
- How does management establish objectives and how is the achievement of those objectives monitored?
- How is your performance evaluated? Is it based on the performance of the company?
- Describe your involvement in regulatory compliance.

Reporting Structure

- Describe the reporting structure of the company, including to whom you report, as well as those reporting to you.
- Describe your interaction with the board of directors, as well as internal/external auditors.
- How is financial information disclosed to the board/shareholders/creditors/others?

Ethics

- Does the company have a code of conduct/ethics in place? Is it enforced? Approved?
- Explain management's commitment to ethics and explain how management conveys that commitment to employees.
  - How does management obtain an understanding of the "tone" throughout the organization?
- When establishing ethics, does the company evaluate what other companies have implemented? If yes, how does the company compare?
- Do you have any knowledge or suspicion of fraud within the company?
- Have you ever had to take a position on an accounting/reporting issue or make an adjustment to the financial statements that you were uncomfortable with or did not fully understand?

Risk Areas

- How are key risks faced by the company identified and monitored?
  - What are the key prospective risks the company faces?
  - How are these risks communicated to your senior management level team and throughout the company?
- What key risks do you monitor in your position?
  - What reports or other methods do you utilize to evaluate the risks?
- Do you monitor risks relevant to specific components or divisions within the entity?

Risk Mitigation Strategies (Internal Controls)

- How often do you discuss with the audit committee/board of directors how the internal control system serves the company?
- How has the NAIC *Annual Financial Reporting Model Regulation* (Model Audit Rule) affected the company and/or the holding company?
- Briefly describe the key aspects of the financial reporting process, including validation of financial information, review and approval, and distribution.
- Describe some of the key management estimates (e.g., loss reserves, etc.) included within the company's financial reports and describe how they are performed, reviewed and approved.
- Describe the budgeting and planning process.
- Briefly describe the month/year-end close process, including manual journal entries and approvals.
- What is the process for adopting/implementing accounting guidance?

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Corporate Strategy

- Where is the company headed strategically? What type of plan is in place to implement this strategy? Has it been approved? How is it being monitored?
- What are your plans for retaining and growing business?
- Explain what types of tools and/or reports you utilize to make key business decisions.
- How do you identify and manage changes in business conditions?
- Explain any strengths or weaknesses of the company, as well as opportunities or threats, the company is facing and how the company is responding to each.
- What key measures do you assess to evaluate the company's performance and competitive position?
- If part of a holding company:
  - How does the holding company contribute to the company's strategy?
  - How might the holding company be impacted by the company's strategy?
- How often do you discuss corporate strategy with your direct reports?

Other Topics

- Explain any significant turnover in your department.
- How are related-party transactions approved and recorded, and how are related-party transactions disclosed to shareholders?
- Is the accounting department adequately staffed?
- How does the company monitor and assess financing needs, as well as access to capital?
- Explain the company's involvement in transactions that include derivative risks.
- Is the company subject to any derivative risks that are not disclosed within Schedule DB of the Annual Statement? If so, please explain.

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Sample Interview Questions for the Chief Operating Officer

Note: *Several different functions/processes could report to the chief operating officer. Some of these areas have questions outlined within this exhibit (e.g., underwriter, actuary, etc.) The examiner will likely need to tailor interview questions for other specific functions that are not included (e.g., claims handling, sales and marketing, human resources, etc.).*

Experience and Background

- How has your professional experience and background prepared you to serve as the Chief Operating Officer for this company?

Duties and Responsibilities

- Briefly describe your duties and responsibilities.
- How does management establish objectives and how is the achievement of those objectives monitored?
- How is your performance evaluated? Is it based on the performance of the company?
- Describe your involvement in regulatory compliance.
- Describe your involvement in the sales and marketing aspects of the company.

Reporting Structure

- Describe the reporting structure of the company, including to whom you report, as well as those reporting to you.
- Describe your interaction with the CEO and other senior management, as well as the board of directors.

Ethics

- Does your company have a code of conduct/ethics in place? Is it enforced? Approved?
- Explain management's commitment to ethics and explain how management conveys that commitment to employees.
- When establishing ethics, does the company evaluate what other companies have implemented? If yes, how does the company compare?
- Do you have any knowledge or suspicion of fraud within the company?

Risk Areas

- How are key risks faced by the company identified and monitored?
  - What are the key prospective risks the company faces?
  - How are these risks communicated to senior management and throughout the company?
- What key risks do you monitor in your position?
  - What reports or other methods do you utilize to evaluate the risks?
- Do you monitor risks relevant to specific components or divisions within the entity?

Risk Mitigation Strategies (Internal Controls)

- How often do you discuss with the audit committee/board of directors how the internal control system serves the company?
- How has the NAIC *Annual Financial Reporting Model Regulation* (Model Audit Rule) affected the company and/or the holding company?
- What internal controls are in place to mitigate risks in the processes you supervise?

Corporate Strategy

- Where is the company headed strategically? What type of plan is in place to implement this strategy? How does the strategy impact activities within your department?
- Explain strengths or weaknesses of the company, as well as opportunities and threats the company is facing, and how the company is responding to each.
- What are your plans for retaining and growing business?
- What key measures do you assess to evaluate the company's performance and competitive position?
- How often do you discuss corporate strategy with your direct reports?

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Other Topics

- Explain any significant turnover in your department.
- How do you ensure that your department is adequately staffed?
- How often are claims reviews or audits performed and by whom? What are examples of items that would be reviewed during the audit?

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Sample Interview Questions for an Internal Auditor

Experience and Background

- How has your experience and background prepared you to serve as an internal auditor for this company?

Duties and Responsibilities

- Briefly describe your duties and responsibilities.
- How is your performance evaluated? Is it based on the performance of the company?
- How much of your department's time is allocated to the NAIC *Annual Financial Reporting Model Regulation* (Model Audit Rule) process, business process reviews, compliance?
- Do you perform any management or accounting functions?
- How are audit findings communicated to the company and the board/audit committee?
- Please describe any special projects and/or key initiatives.

Reporting Structure

- Describe the reporting structure of the company, including to whom you report as well as who reports to you.
- Describe your interaction with the board of directors/audit committee, external auditors and/or senior management.
- How do you monitor/follow up on audit findings? Are findings classified as to significance?

Ethics

- Does the company have a code of conduct/ethics in place? Is it enforced? Approved?
- Explain your commitment to ethics and explain how you convey that commitment to your employees.
- How does the company compare to others in terms of its position on ethics?
- Do you have any knowledge or suspicion of fraud within the company?

Risk Areas

- How are key risks faced by the company identified and monitored?
  - What are the key prospective risks the company faces?
  - How are these risks communicated to senior management and throughout the company?
- What key risks do you monitor in your position?
  - What reports or other means do you utilize to evaluate the risks?
- Do you monitor risks relevant to specific components or divisions within the entity?
- How do you determine which audits to perform and the appropriate scope for those audits?

Risk Mitigation Strategies (Internal Controls)

- How does the internal audit department address the potential for override of internal controls?
- Do you discuss with the audit committee/board of directors how the internal control system serves the company? How often?
- How has the NAIC *Annual Financial Reporting Model Regulation* (Model Audit Rule) affected the company, if at all? How has it affected the holding company and/or the internal audit department?
- Describe any internal control issues discussed during the most recent audits.
- Do you review the company's application of accounting guidance?

Corporate Strategy

- Explain strengths or weaknesses of the company, as well as opportunities and threats the company is facing, and how the company is responding to each.
- What key measures do you assess to evaluate the company's performance and competitive position?
- If part of a holding company:
  - How does the holding company contribute to the company's strategy?
  - How might the holding company be impacted by the company's strategy?
- How often do you discuss corporate strategy with your direct reports?

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Other Topics

- Explain any significant turnover in your department.
- How do you ensure the internal audit department is adequately staffed?
- How are internal audit members hired?
- Are any internal audit functions outsourced?
- Is the company involved in transactions that include derivative risks?
- Is the company subject to any derivative risks that are not disclosed within Schedule DB of the Annual Statement?

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Sample Interview Questions for Investment Management

Experience and Background

- How has your professional experience and background prepared you to manage the investments for this company?

Duties and Responsibilities

- Briefly describe your duties and responsibilities.
- How does management establish investment objectives and how is the achievement of those objectives monitored?
- Describe the governance structure over investments?
- Are there written investment guidelines that the company must follow?
  - Do you or others monitor them for compliance?

Reporting Structure

- Describe the organizational structure of the investment function.
- Describe the reporting structure of the company, including to whom you report, as well as those reporting to you.
- Describe your interaction with the board of directors and the CEO.
- What is the composition and role of the investment committee, and is the committee independent from operational management?
  - How often does the investment committee meet?
  - What are their areas of concern?

Ethics

- Does the company have a code of conduct/ethics in place? Is it enforced? Approved?
- Explain management's commitment to ethics and explain how management conveys that commitment employees.
- Do you have any knowledge or suspicion of fraud within the company?

Risk Areas

- What is the company's risk tolerance for investments and how is that communicated?
- How does the company monitor risks related to investments (e.g., interest rate risk, credit risk, etc.)?
- How does the company review its risk/reward trade-off?
- How does the company determine its asset allocation strategy?
- Does the company consider the impact of climate change risks when determining its investment strategy and/or monitoring the risks in its investment portfolio? If yes, please explain.

Risk Mitigation Strategies (Internal Controls)

- What is the formal procedure for reporting on risk management to senior management and the board?
- What types of internal controls exist to ensure adherence to investment policies and procedures?
- How is performance and compliance gauged (both with statutory rules and internal investment policies)?
- Who monitors potential impairment issues?
  - How often?
- What types of controls and authorizations are in place to transfer money?
  - Are all employees with access to funds bonded?
- Are all transactions approved by senior management?
- How does the company monitor and determine the value for its Schedule BA investments?
- How are assets and liabilities matched at the company?

Corporate Strategy

- Where is the company headed strategically? What type of plan is in place to implement this strategy? How does the strategy impact activities within your department?

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- Explain strengths or weaknesses of the company, as well as opportunities and threats the company is facing, and how the company is responding to each.
- Is the company-wide strategy clearly communicated by senior management to the rest of the company?
  - How does that impact your department's goals/activities?
- Explain what tools or reports you utilize to make key business decisions.

Other Topics

- Explain the company's involvement in transactions that include derivative risks.
- Is the company subject to any derivative risks that are not disclosed within Schedule DB of the Annual Statement? If so, please explain.

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Sample Interview Questions for Internal Legal Counsel

Experience and Background

- How has your professional experience and background prepared you to serve as legal counsel for this company?

Duties and Responsibilities

- Briefly describe your duties and responsibilities.
- How do you identify any potential legal issues that may arise within the company?

Reporting Structure

- Describe the reporting structure of the company, including to whom you report, as well as who reports to you.

Ethics

- Does the company have a code of conduct/ethics in place? Is it enforced? Approved?
- Explain management's commitment to ethics and explain how management conveys that commitment to employees.
- Do you have any knowledge or suspicion of fraud within the company?

Risk Areas

- How are key legal and regulatory risks faced by the company identified and monitored?
  - What are the key prospective risks the company faces?
  - How are these risks communicated to senior management and throughout the company?
- Explain any significant (use a predetermined threshold) lawsuits/legal actions outstanding against the company?
- Are the number of lawsuits fluctuating or remaining constant?

Other Topics

- Has there been any turnover in your department?
- Describe your staff's experience.
- Are any legal functions outsourced? How are those functions monitored?

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Sample Interview Questions for Chief Risk Officer

Experience and Background

- How has your professional experience and background prepared you to serve as the Chief Risk Officer for this company?

Duties and Responsibilities

- Briefly describe your duties and responsibilities.
- How does your role/function relate to, or how is it integrated with Sarbanes-Oxley Act and/or NAIC *Annual Financial Reporting Model Regulation* (Model Audit Rule) processes, internal audit and/or other departments?
- Describe the major projects taking place and how you divide your departments time (i.e., what are the areas of focus)?
- Do you publish reports/findings?
  - To whom are they distributed and how often are they distributed?

Reporting Structure

- Describe the reporting structure of the company, including to whom you report, as well as who reports to you.
- Is there a board-level committee or other group that you report to?
  - Is that group independent from your area of management?
  - What is their role and how do you interact with them?
- Describe those who have been involved (e.g., your team, internal audit, operational areas, consultants, external auditors, etc.) and their roles in the Model Audit Rule compliance process.
- Are there any financial ties to company profits within your compensation package?

Ethics

- Does the company have a code of conduct/ethics in place? Is it enforced? Approved?
- Explain management's commitment to ethics and explain how management conveys that commitment to employees.
- When establishing ethics, does the company evaluate what other companies have implemented? If yes, how does the company compare?
- Do you have any knowledge or suspicion of fraud within the company?

Risk Areas

- How are key risks faced by the company identified and monitored?
  - What are the key prospective risks the company faces?
  - How are these risks communicated to senior management and throughout the company?
- Do you monitor risks relevant to specific components or divisions within the entity?
- What key risks do you monitor in your position?
  - What reports or other means do you utilize to evaluate the risks?
- Does your company consider the impact of climate change risks as part of its overall risk management practices?
  - If so, what risks have you identified related to the impact of climate change risks?
  - If so, what is done to analyze and mitigate each of those risks? Is this done independently or as part of weather-related risks in general?
- Are you involved in the company's process for establishing and monitoring reserving risks?
  - If so, please describe the company's process to establish and monitor reserving risks.

Risk Mitigation Strategies (Internal Controls)

- What is the formal procedure for reporting on risk management to senior management and the board?
- What is the company's plan for operating in crisis/disaster – business continuity?
- From a strategic perspective, how are risks addressed across all business units and entities?

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- How has the Model Audit Rule affected the company, if at all? How has it affected the holding company and/or the internal audit department?
- Does the organization structure allow for proper segregation of duties?
- What internal controls exist to ensure adherence to company policies and procedures, as well as regulatory procedures?
- What procedures are in place to diversify risks?
- What strategies are used for managing the most significant risks facing the company?
- Are executive officers and management team members required to disclose personal business or family relationships with organizations in which your company invests?
- Describe any compliance-related training conducted by the organization.
  - Is the training required?
- Are quality reviews performed by internal auditors or other means within the company?
- How are goals set and performance evaluated?
  - How is that linked to responsibility and accountability?
  - How does all of that impact the divisional level?
- What is the nature and extent of incentive compensation throughout the company?
  - How are risks related to compensation identified, monitored and mitigated?

Corporate Strategy

- Explain strengths or weaknesses of the company, as well as opportunities and threats the company is facing, and how the company is responding to each.

Other Topics

- Do you have an organization-wide integrated risk management framework?
- Explain the company's involvement in transactions that include derivative risks.
- Is the company subject to any derivative risks that are not disclosed within Schedule DB of the Annual Statement? If so, please explain.

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Sample Interview Questions for Underwriting

Experience and Background

- How has your professional experience and background prepared you to serve as an underwriter for this company?

Duties and Responsibilities

- Briefly describe your duties and responsibilities.
- Describe the company's book of business.
  - Program business, treaty, facultative.
  - Mix of property/liability.
  - Mix of excess/quota share.
- Are there written underwriting guidelines that the company must follow?
  - Do you or others monitor them for compliance?
  - Do you have a written best practices checklist that includes quality standards?
- How do you monitor regulatory compliance?
- How do you evaluate your staff?
- Describe how your underwriters' skill levels are developed.

Reporting Structure

- Describe the reporting structure of the Underwriting Department, including to whom you report, as well as those reporting to you.
- Is there an underwriting committee?
  - How is it organized and who are its members?
- Describe your interaction with the CFO/CEO/BOD.
  - Do you provide them with any specific reports?

Ethics

- Does the company have a code of conduct/ethics in place? Is it enforced? Approved?
- Explain management's commitment to ethics and explain how that commitment is conveyed to employees.
- Do you have any knowledge or suspicion of fraud within the company?
- Does the company require ethics training for underwriters and brokers?

Risk Areas

- How are key risks faced by the company identified and monitored?
  - What are the key prospective risks the company faces?
  - How are these risks communicated to senior management and throughout the company?
- What key risks do you monitor in your position?
  - What reports or other means do you utilize to evaluate the risks?
- Describe the development and approval process for new products.
- What are the underwriting authorization levels?
- Which lines of business performed well/poorly in the past?
- What percent of your cases are automatically underwritten vs. manually underwritten?
- How do you determine if you are you underwriting the cases you should?
- Give a general description of product pricing.

Risk Mitigation Strategies (Internal Controls)

- How does the company ensure that correct contractual language and rates are used?
- What controls are in place to ensure underwriting guidelines are followed?
- How are brokers monitored to ensure compliance with underwriting standards?
- How often are underwriting audits performed and who performs them?
- How do you ensure that what is underwritten gets entered as premium correctly?
- How does the underwriting function fit into the overall corporate strategy?

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- Do you have a documented procedure for following actual loss to expected loss ratios?
- What types of reports do you use to monitor underwriting activity?
- How is premium adequacy maintained?

Corporate Strategy

- Where is the company headed strategically? What type of plan is in place to implement this strategy? How does the strategy impact activities within your department?
- Explain strengths or weaknesses of the company, as well as opportunities and threats the company is facing, and how the company is responding to each.
- Explain what tools or reports you utilize to evaluate underwriting decisions.
- What key measures do you assess to evaluate the company's performance and competitive position?

Other Topics

- Explain any significant turnover in the underwriting department.
- Explain the distribution channels used by the company.
- What is the compensation/commission structure for each distribution channel?
- How do you ensure that your staff is handling an appropriate number of cases?

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Sample Interview Questions for the Chief Actuary

Experience and Background

- How has your professional experience and background prepared you to be the Chief Actuary for this company?

Duties and Responsibilities

- Briefly describe your duties and responsibilities.
- How does management establish objectives, and how is the achievement of those objectives monitored?
- How is your performance evaluated? Is it based on the performance of the company?

Reporting Structure

- Describe the reporting structure of the actuarial function, including to whom you report, as well as those reporting to you.
- Is there a reserving committee?
  - How is it organized and who are its members?
  - How are differences resolved?
- Describe your interaction with the CFO/CEO/BOD.
  - Do you provide them with any specific reports?
- Do the board/audit committee members demonstrate an understanding of the variability inherent in the reserves?
- How does the board/committee oversee the application of Principle Based Reserving (if applicable)?

Ethics

- Does the company have a code of conduct/ethics in place? Is it enforced? Approved?
- Explain management's commitment to ethics and explain how that commitment is conveyed to employees.
- Do you have any knowledge or suspicion of fraud within the company?

Risk Areas

- How are key legal and regulatory risks facing the company identified and monitored?
  - What are the key prospective risks the company faces?
  - How are these risks communicated to senior management and throughout the company?
- Have there been changes in the appointed actuary in recent years and, if so, how often have such changes occurred and why?
- What is the current reinsurance program? Describe any changes over the past five years.
- Describe the company's process to establish Principle Based Reserves.
  - Does the company have credible experience or experience studies to substantiate the model assumptions?
  - Does the company use a vendor supplied or internally developed Cash Flow Model?

Risk Mitigation Strategies (Internal Controls)

- What is the formal procedure for reporting on risk management to senior management and the board.
- What controls are in place to ensure reserving guidelines are followed?
- Who determines which reserves will be booked in the financial statements quarterly and/or annually?
  - Does the company book to the actuary's point estimate, or is there a monitored gap?
- How often are all reserve analyses performed?
- Does the company book to the actuary's point estimate, or is there a monitored gap?
- Is the actuarial opinion signed by a company actuary or a consultant?
- Does the company use commercial software or "homegrown" spreadsheets? What controls are in place to check [illegible]
- How are pricing and underwriting monitoring integrated into the reserving process?
- Is there a peer review of the reserving actuary's work? If so, who performs it?
- How much reliance does the appointed actuary place on the work of others?
- Describe the controls in place over the PBR processes.
- Has the company instituted any new controls as a result of the implementation of Principle Based Reserving (if applicable)?

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- Describe the modeling controls in place supporting the Principle Based Reserving processes (e.g. model validation, changes in modeling assumptions, etc.).

Corporate Strategy

- Give a general description of the company's reserving philosophy.
- Explain what types of tools or reports you utilize to evaluate actuarial decisions.

Other Topics

- What is the quality of the actuarial report, with respect to completeness and clarity of documentation?
- What actions have been taken to apply PBR methodologies? (*Life Insurers Only*)
  - How are system capabilities considered in preparation for PBR implementation?
  - What system changes were made to apply PBR?
  - How are staffing needs, appropriate expertise and availability of effective training evaluated in preparation for PBR implementation?
  - What changes to staffing and training were made to apply PBR?
  - Discuss management's commitment to successful implementation of PBR

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Sample Interview Questions for a Captive Manager and/or Other Contracted Parties (for Risk Retention Groups)

Experience and Background

- Who are the team members on this account and what are their backgrounds?
- Has there been any turnover since the prior exam?
- How does your experience and background qualify you to oversee this account?
- Are you and your team members independent of the company?

Duties and Responsibilities

- What are your organization's duties and responsibilities with regard to the RRG? Are these duties and responsibilities identified in a contract? (If so, obtain a copy of the contract.)
- Briefly describe your duties and responsibilities.
- How does management establish objectives and how do you monitor achievement of these objectives?
- What is your level of involvement in managerial decisions specific to this account?
- What is your team's responsibility in regards to the following areas:
  - Accounting and Financial Reporting
  - Cash Handling
  - Investments
  - Claims
  - Premiums
  - Reinsurance
  - Regulatory Compliance (state, federal, etc.)
  - Other?

Reporting Structure

- Explain the organization and reporting structures of the company.
- Describe your interactions and relationship with company management. How frequent are these interactions?
- How often do you receive reports from management, TPAs or other internal or external sources?
  - What information is reported?
- Have you encountered any issues obtaining information from management, TPAs or other internal or external sources?
- Are there any inconsistencies in information received from the company contact, TPAs or other internal or external sources?

Ethics

- Do the company and management team both have a code of conduct/ethics in place? How are they enforced?
- Do you have any knowledge or suspicion of fraud within the company?

Risk Areas

- What do you perceive to be the key risks (including prospective) affecting this company?
- How are these key risks monitored?

Corporate Strategy

- Are you aware of any current or future changes that will have an effect on this organization?

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EXHIBIT Z
EXAMINATION COORDINATION

Holding company group examination coordination is an important element in conducting financial condition examinations. Many companies are members of groups or holding company systems having multiple insurers and often more than one state of domicile. This exhibit should be used when the group includes multiple companies with more than one state of domicile. These affiliated companies often share common management along with claims, policy and accounting systems, and participate in the same reinsurance arrangements. To improve examination efficiencies, the designated Lead State should take a leadership role in communicating with the other states within a group to identify companies for coordinated examinations, identifying areas in which work may be leveraged to prevent duplication, and improving the use of resources. However, even though Lead States are required to take a leadership role in this process, all states have a responsibility to communicate with other states within a group to facilitate coordination. An attempt should be made to coordinate all companies within a holding company group unless there are valid reasons for scheduling examinations of companies within a group at differing times. However, coordination efforts should take into account state statutes and the NAIC accreditation requirements regarding the frequency of full-scope examinations. States must be sure to comply with state statutes and the NAIC accreditation requirements when coordinating examinations. In situations where coordination of examinations is not possible, it may still be possible to share confidential information and place reliance on existing testwork.

This exhibit should be utilized to adequately document examination coordination efforts to ensure that adequate communication occurs and methods to increase examination efficiencies are identified. Correspondence regarding examination coordination and measures to increase examination efficiencies should be ongoing. Documentation of all coordination efforts occurring during the initial phases of an examination, as well as those efforts occurring prior to the actual start of the examination, should be included in the examination workpapers or in the Department's files. To assist in planning for an upcoming coordinated examination, Part One of this exhibit should be sent by the Lead State to holding company group personnel well in advance of the performance of any planning work on the group examination, which includes calling the exam and sending the Examination Planning Questionnaire (Exhibit B). Part Two of this exhibit should be completed in the early stages of planning the examination to document the attempt to coordinate.

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PART ONE – INPUT FROM HOLDING COMPANY GROUP PERSONNEL

The coordination of financial examinations for insurers within holding company groups is beneficial to state regulators as well as the companies being examined. In order to assist examiners and to create exam efficiencies for both company personnel and state examiners, information about the companies that compose a holding company group is needed. Based on the information below, the holding company group should provide input to state regulators on several items that provide regulators with a high-level understanding of the interactions of companies in the holding company group. When completing the exhibit, the holding company group should provide input on whether subgroups for financial exam purposes are appropriate. If so, the group should provide information detailing how it could be broken out into those subgroups for this exam period. For example, a holding company group is comprised of eight insurance entities that include five companies writing health insurance and three writing life business. This group may be separated into two subgroups based on the information discussed above, one for the health companies and one for the life companies. The group may also provide input on an exam facilitating state for each subgroup created. The holding company group may also provide input as to whether a coordinated exam(s) makes sense given the unique characteristics of a particular group.

At a minimum, the holding company group should provide information on each of the four key topics discussed below to assist regulators when scheduling exams of the group. Examples of information that the group may consider when providing input to state regulators for each key topic are also provided. The examples listed below are optional pieces of information the group may provide for each of the key topics. This list is not all-inclusive and the holding company group should consider any other sources of information that they believe would be beneficial to the regulators in scheduling and coordinating group exams. Although the examples are kept at a high level in order to apply to all groups in some fashion, the information gathered by company personnel should provide sufficient evidence and detail to assist regulators in determining the best way to coordinate exams for a holding company group.

1. Group Corporate Governance
    - Organizational chart of the group (Exhibit Y – Annual Statement) including ownership percentages shown and any significant changes noted.
    - Company organizational charts with director names for each legal entity explaining which board(s) of directors and committees oversee which entities and/or holding companies.
    - A general written description of how the board of directors is involved in the decisions made with respect to the insurance operations.

2. Risk Management/Decision Making
    - Similarities and differences in lines of authority and communication (including senior management and board of directors) for group/company operations to facilitate more effective and focused interviews of management.
    - Risk management and decision making levels for the group.
    - Financial plans and management concerns and risks for each legal entity.
    - Similarities and differences of risk management between companies.
    - Internal audit program over multiple companies.

3. Key Functional Activities and Processes
    - "Mutual service" departments or business units that service multiple companies within the group (e.g., IT, accounting, investments, claims handling, premium processing, executive, etc.), including centralized functions in place across the legal entities.
    - Similarities and differences of significant processes and operations within the group, including markets, distribution channels and internal controls.
        - Could include documentation from Model Audit Rule or Sarbanes-Oxley requirements such as a description of the "Group of Insurers" determined for purposes of Model compliance.

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- This information should be presented in a well-organized and easy to follow manner, as similar processes will serve as the primary areas where coordinated examination of systems and processes can occur among the states.

- Location of books and records for each insurer.
- Information on significant agreements and transactions with affiliates.

4. Computer Systems
   - Listing of common administration and IT systems used by multiple or all companies in the group, including flowcharts and locations.
     - Names of experts who manage these systems.
     - Location(s) of systems.
     - System controls and applications/processes.
     - Could be broken out by dollar amount and percentage of total processed (e.g., 25% of claims processed in Kansas City, 75% in New York City).

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PART TWO – DOCUMENTATION OF EXAMINATION COORDINATION EFFORTS

Part Two of this Exhibit was developed to facilitate documentation of examination coordination efforts. Each state belonging to a holding company group should complete the applicable section(s) below.

Part Two – Section A: Lead State

This section of Exhibit Z, Part Two is to be completed by the Lead State of the holding company group, regardless of participation in the examination. If the Lead State will be acting as the Exam Facilitator, both Part Two – Section A and Part Two – Section B must be completed.

1. Describe the global coordination plan for the holding company group.

   _____

   _____

   _____

   a) Should all companies within the holding company group be examined together as part of a coordinated examination? If no, describe expected subgroups.

      _____

      _____

      _____

   b) Document relevant dates pertaining to the global coordination plan, including expected examination schedule and projected timelines.

      _____

      _____

      _____

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2. Document steps taken to communicate the global coordination plan with companies within the holding company group.

_____

_____

_____

a) Indicate which states have agreed to conduct examinations of domestic entities within the holding company group in accordance with the global coordination plan.

_____

_____

_____

Part Two – Section B: Exam Facilitator

This section of Exhibit Z, Part Two is to be completed by the Exam Facilitator. If the Exam Facilitator is not also the Lead State, the Exam Facilitator must obtain Part Two – Section A from the Lead State of the holding company group for inclusion in the exam file.

1. How does this examination fit into the global coordination plan for the group in which the company(ies) belong?

_____

_____

_____

2. List each state that is participating in this coordinated examination.

_____

_____

_____

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3. Describe the plan for ongoing oversight of the coordinated effort, including periodic status updates from states performing work in support of the coordinated effort.

Part Two – Section C: Participating State in a Fully Coordinated Examination

This section of Exhibit Z, Part Two is to be completed by the states participating in a fully coordinated examination. This section should be utilized to demonstrate active participation in the coordinated examination effort. Participating states may provide additional information as deemed necessary to evidence participation. For additional guidance regarding responsibilities of participating states in fully coordinated examinations, refer to Section 1, Part I (D), Coordination of Holding Company Group Exams (Coordination Framework).

1. Document and/or reference evidence of active participation in the planning phase of the coordinated examination. This may include input regarding risks and/or key activities, suggested interview questions, review of the planning memo, etc.

2. Document ongoing participation in the examination (e.g., periodic status updates, etc.)

3. Document communication with the exam facilitator regarding state-specific procedures to be performed by the participating state. Include a summary of such work, including a reference to where performed.

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4. Document and/or reference evidence of active participation in the wrap-up phase of the coordinated examination. This may include participation in the exit meeting, suggestions for comments for the management letter, etc.

_____

_____

_____

5. Provide additional information as deemed necessary to demonstrate fulfillment of the responsibilities of the states participating in a fully coordinated examination, as outlined in Section 1, Part I.B.3, Coordination of Holding Company Group Exams (Coordination Framework).

_____

_____

_____

Part Two – Section D: Other States

This section of Exhibit Z, Part Two is to be completed by the states that are part of a holding company system but did not participate in a coordinated group examination of the holding company group or those that utilized existing work outside of a fully coordinated group examination. In these circumstances, the state must obtain Part Two – Section A from the Lead State of the holding company group for inclusion in the exam file.

1. If non-participation of this company is in accordance with the global coordination plan, provide reference to the global coordination plan.

_____

_____

_____

2. If non-participation of this company is not in accordance with global coordination plan, document the rationale for not participating in the coordinated group examination. Include reference(s) to communication with the Lead State and/or Exam Facilitator regarding non-participation.

_____

_____

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a. Document efforts to coordinate future examinations.

_____

_____

_____

b. If a valid regulatory concern exists that would interfere with future coordination, consider, with input from the Lead State, if the global coordination plan should be revised.

_____

_____

_____

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EXHIBIT AA
SUMMARY REVIEW MEMORANDUM

The following is an illustration of how a summary review memorandum (SRM) may be set up to assist examiners in documenting the key issues and results of a risk-focused examination that should be shared with the Chief Examiner and the assigned analyst. The illustration also includes a high-level overview of the insurer's holding company structure (if applicable) and how that structure affected exam coordination with other states. Additionally, the SRM includes discussion of the insurer's governance and risk management practices, and a summary, by branded risk classification, of significant exam findings and/or concerns warranting communication. These findings may include overarching solvency concerns, examination adjustments, other examination findings, management letter comments, subsequent events and other residual risks or concerns the examiner may want to communicate to department personnel. The final sections, prioritization level and changes to the supervisory plan, provide discussion of the examiner's overall conclusions regarding ongoing monitoring, including specific follow-up recommended to the analyst .

This exhibit provides an example template, which is not intended to be all-inclusive and should be tailored to each examination. Reference to each branded risk classification is necessary and should be included in the examination's SRM; however, it is not necessary to address each of the supporting areas and points discussed herein. Therefore, the examiner-in-charge should use his or her judgment in determining which sections of this illustration are applicable and document any other relevant information deemed necessary. The purpose of the SRM is to provide interpretative analyses relative to significant examination areas and to provide a basis for communicating examination findings and recommendations to department personnel. In so doing, the SRM will provide input into the Insurer Profile Summary (IPS) and the supervisory plan. In fulfilling this purpose, the SRM should not merely repeat comments made in the examination report or management letter, but instead provide a comprehensive summary of examination conclusions both objective and subjective in nature. Conclusions should provide information necessary for ongoing supervision of the insurer that includes areas of concern as well as areas that support a positive outlook for the insurer.

COMPANY NAME: **EXAMINATION DATE:**

EXAMINATION BACKGROUND

The purpose of this section of the memorandum is to document at a high level what, if any, group the insurer belongs to, if the insurer was part of a coordinated exam and how the coordinated exam was conducted. Additional information regarding the timing of the exam, staffing resources utilized—including what specialists were used—or other background information necessary to understand the results presented in the memo should also be included.

GOVERNANCE AND RISK MANAGEMENT

The purpose of this section of the memorandum is to summarize an understanding and assessment of an insurer's board of directors, senior management and organizational structure, as well as the results of the review of the enterprise risk management (ERM) function of the insurer. This assessment should include information obtained during both the planning and the completion stages of the examination. Therefore, consideration of information gathered during C-level interviews, completion of Exhibit M and review of the insurer's Own Risk and Solvency Assessment (ORSA), if applicable, should be combined with information obtained during detail testwork to reach a concise final assessment that focuses on communicating significant areas of strength or weakness within the overall corporate governance and ERM functions of the insurer. When the insurer is part of a holding company, documentation should reference the level at which conclusions are reached. Additional assessment may be necessary at the individual entity level, but the primary focus of the assessment will commonly be at the holding company level in a coordinated examination.

BRANDED RISK ASSESSMENTS

This section of the memorandum should be organized to address each of the nine branded risk classifications: Credit; Legal; Liquidity; Market; Operational; Pricing/Underwrting; Reputation; Reserving; and Strategic. If needed, an Other category may also be used. In documenting each assessment, consideration should first be given to the branded risk

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assessments provided by the analyst in the initial IPS. The examiner then summarizes the work performed during the examination to arrive at a final assessment for each classification. For those branded risk classifications that are not impacted by examination results and provide no additional information for the ongoing monitoring of the insurer, this can be noted without further explanation. For those classifications that are impacted, documentation in the summary should focus on new information uncovered during the course of the examination and should not duplicate the summary initially provided in the IPS. The summary for each classification should be prepared at a level of detail that will enable the analyst to update the existing IPS and understand the context for items that require additional follow-up or specific monitoring procedures. This may be done within the table format provided below, referencing other examination documents as necessary.

In documenting the key points for each branded risk classification, consideration should be given to the following areas, if deemed applicable:

- Prospective solvency concerns
- Examination adjustments
- Control/risk mitigation strategy issues
- Report findings and management letter comments
- Responses to issues raised by financial analysis
- Subsequent events
- Residual risks and concerns

Following the summary, the examiner should update the areas of concern, as needed, based on the information obtained during the examination and provide an overall assessment of minimal, moderate or signficant concern for each branded risk classification. If the examiner's assessment is different from the original assessment documented in the IPS, the information summarized must provide sufficient detail to support the change. Issues that require specific monitoring or follow-up by the analyist should then be identified individually in the table under the section designated for recommended follow-up. This table includes a brief reference to the issue, recommended follow-up or action items to be performed and the timeline in which the analyst should expect to obtain information referenced in the follow-up procedures.

Branded Risk Classification *(Example: Credit)*

Note: A separate summary and table should be completed for each of the nine branded risk classifications, as well as a category for Other, if deemed necessary.

Analyst Initial Assessment

Credit: This risk is considered moderate, driven primarily by a fairly conservative investment mix (96.4% of bonds are NAIC 1 designation, with 28% U.S. government, 41% U.S. states and most of the rest high-quality corporates) and limited exposure to equities, offset by a relatively high amount of real estate ($33 million), growing agent balances ($99 million) and significant reinsurance recoverables (paid and unpaid) of $81 million. However, the reinsurance recoverables are diversified across a number of highly rated reinsurers.

No/Minimal Concern	Moderate Concern	Significant Concern	Trend
Bonds			↔
Reinsurance Recoverables			↑
	Real Estate – Home Office		↔
		Agent Balances and Uncollected Premiums	↑
Analyst Initial Overall Assessment: Moderate		**Overall Trend: ↔**	

Examiner Summary and Assessment

Credit: Examiner agrees with analyst assessment regarding bonds and reinsurance recoverables. Although the reinsurance recoverable balance has increased significantly in recent years, the change is in line with increases in premium volume and strategic plan of partnering with high-quality reinsurers to increase the volume of its product liability business. Real Estate – Home Office was tested during the exam, with a recent appraisal reviewed showing the value of the property to be $40 million. Therefore, the examiner proposes that the credit risk associated with the home office be reclassified as a minimal concern. In reviewing agent balances, the exam team recognized a growing concern regarding slow-paying agents for the company's growing product liability business. In discussing this with the company, a lack of company controls related to agency audits was noted. As such, the exam team agrees with the analyst's assessment of high credit risk in this area and has included a management letter comment regarding agency audits as described below.

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No/Minimal Concern	Moderate Concern	Significant Concern	Trend
Bonds			↔
Reinsurance Recoverables			↑
Real Estate – Home Office			↔
		Agent Balances and Uncollected Premiums	↑
Examination Overall Assessment: Moderate		**Overall Trend:**	

Recommended Follow-Up		
Issue	**Recommended Follow-Up**	**Timeline**
See ML #2 – Lack of a consistent agency audit process	Company was asked to establish a consistent agency audit plan to ensure accurate and complete premium and claim reporting. Analyst is asked to follow-up on company activity in this area by requesting a copy of the audit plan and selecting a sample of agency audit reports to request and review.	Company has stated that it plans to increase its IA staffing over the next six months to support additional agency audits. Therefore, follow-up as part of the next annual financial statement analysis is recommended.

ISSUES OF NON-COMPLIANCE

The purpose of this section is to describe any issues of non-compliance identified during the examination. These issues typically do not have a significant impact on the assessment of each branded risk classification, but are important to communicate and ensure proper follow-up is performed.

Recommended Follow-Up		
Issue	**Recommended Follow-Up**	**Timeline**
See ML #1 – Schedule F reporting	Company was asked to report reinsurance data on Schedule F on a gross basis in all instances. Analyst asked to follow-up by closely monitoring Schedule F and reinsurance Jumpstart reports.	Follow-up recommended in conjunction with quarterly and annual financial statement analysis through 20XX.

PRIORITIZATION AND ONGOING MONITORING

The purpose of this section of the memorandum is to allow the examiner to document any suggested changes to the prioritization level and/or to document the examiner's rationale for maintaining the current prioritization level.

PROPOSED CHANGES TO SUPERVISORY PLAN

The purpose of this section of the memorandum is to propose any changes to the supervisory plan that the examiner believes are necessary based on the preceding information.

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EXHIBIT BB
SUMMARY OF UNADJUSTED ERRORS

Examiners may encounter individually small misstatements that are not considered material to the company and are so insignificant as to not require an adjustment within the examination report. Where an adjustment is not made, the examiner must ensure that these individually immaterial misstatements are not material in the aggregate or do not involve violations of law. The purpose of this exhibit is to assist the examiner in gauging and summarizing the aggregate effect of all errors that were not individually material enough to correct within the report of examination.

Each error within the Summary of Unadjusted Errors (SUE) should be separately identified as to whether it is a known error or a likely error. Known errors are those errors that are quantifiable as a result of the testing procedures performed. Likely errors are identified through the extrapolation of misstatements found in a statistical sample or are based on the professional judgment and opinion of the examiner. The defining characteristic of a likely error is that the amount cannot be exactly identified. Errors that the examiner has adjusted in the exam report should not be included in the SUE, although the examiner should maintain a separate summary that shows those adjustments that will be included in the examination report.

Using the SUE, the examiner should review the effects of the errors on the various financial statement components and assess whether the aggregate effect of these errors is close to, or exceeds planned tolerable error. This review may indicate whether certain unadjusted errors should be included in the examination report. The determination of which errors to include in the examination report is up to the professional judgment of the examiner-in-charge. Additional guidance on the SUE can be found in Section 1, Part IV.

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SUMMARY OF UNADJUSTED ERRORS WORKSHEET

Tolerable Error: _____ **PAJE Scope:** _____

W/P Ref.	Account Description	Debit	(Credit)	Type of Error (Known or Likely)	Net Admitted Assets	Liabilities	Surplus	Income Statement

EXHIBIT CC
ISSUE/RISK TRACKING TEMPLATE

The primary goal in Phase 1 of the examination is to gain an understanding of the company being examined to enable the critical risks facing an insurer to be identified. Issues and risks can be identified from numerous sources including the interview process, communication with analysts, a review of corporate governance information, a review of information available through the internal and external audit functions, a review of IT functions and documentation, and other assessments completed as part of Phase 1.

Exhibit CC is intended to house significant issues and risks identified during Phase 1 to ensure that they are appropriately addressed and/or considered during the examination. Examiners should use the template below, or a substantially similar document, to track the issues and risks identified, which include prospective risks. However, examiners are not expected to utilize this template to identify each and every risk that will be included on a key activity matrix. Instead, this template should be utilized to identify risks that could include those unique to the insurer, specific to a particular line of business/company activity or of heightened importance as determined through gaining an understanding of the company.

When using this template, the examiner should document the issue or risk identified and its source(s). If an issue or risk has multiple sources, the examiner need only list the issue or risk once on the template and should document all significant sources from which it was identified in the adjacent box. In addition, the examiner should include the area where the issue or risk is addressed (e.g., on a key activity matrix, on Exhibit V, etc.) and any additional information deemed necessary. Alternately, after further review, the examiner may determine that no follow-up is necessary for an issue or risk identified; in those instances, the examiner should document this conclusion on the template.

Instructions for completing and documenting the issues or risks identified within the template are as follows:

Template Column	Instructions for Completing
Issue/Risk Identified	Based on the knowledge and understanding of the company obtained during Phase 1 of the examination, document the issue/risk identified, including prospective risks.
Source(s) of Issue/Risk	Identify the source(s) of the issue/risk. Examples include but are not limited to: communication from the financial analyst, communication from other regulators (other states, federal, international, etc.), A.M. Best reports, AICPA audit alerts, review of regulatory filings, C-level interviews, review of minutes, department planning meeting notes, market conduct reports, company risk assessments, etc.
Where Addressed	Provide a reference to where the issue/risk is addressed, such as a key activity matrix, Exhibit V, or other areas within the examination file.
Additional Information	If no follow-up is necessary for an issue or risk identified, briefly document this conclusion and/or provide any additional information deemed necessary to further clarify the issue/risk.

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Example risks have been included below to demonstrate the level of documentation expected to be included in a tracking template.

Issue/Risk Tracking Template

Issue/Risk Identified	Source(s) of Issue/Risk	Where Addressed	Additional Information
Example 1 – Company plans to begin writing a new line of business next year.	*Issue referred from rates and forms unit (A.1.6) and brought up in C-Level interviews (A.3.5, A.3.7).*	*See Exhibit V (Risk 3).*	*N/A*
Example 2 – The percentage of the company's invested assets held in equities has increased significantly over the past two years.	*Issue referred by the financial analyst (see A.1.5) and discussed in the department planning meeting (see A.1.12).*	*See risk 1.1 on the Investment Risk Matrix (C.2.3).*	*N/A*
Example 3 – The company's expense ratio is significantly higher than the industry average.	*Issue noted during examiner's review of the AM Best report (see A.1.7).*	*Not deemed necessary.*	*After further discussion, it was noted that the company's historical expense ratios are higher than the industry average due to the unique coverage written by the company. As ratios have been relatively flat and the company remains profitable, no additional review is deemed necessary.*

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EXHIBIT DD
CRITICAL RISK CATEGORIES

One of the goals of a risk-focused examination is to focus on the most critical financial solvency risks facing an insurer. To assist the examination team in meeting this goal, a list of critical risk categories has been developed for consideration in reviewing the adequacy of risk statements developed for each examination. The initial identification of risks in Phase 2 should utilize the understanding of the company gained in Phase 1, as well as a consideration of branded risk classifications, exam assertions, etc. The critical risk categories can then be used at the end of Phase 2 to ensure that the risks identified through this process cover some of the most common solvency risks identified by insurance regulators. The expectation is that each critical risk category will be addressed by at least one risk statement on a key activity matrix (or Exhibit V). Alternatively, if the exam team determines that a particular category is not applicable or critical to the company being examined (i.e., the company does not have exposure in the category), an explanation may be provided within the Examination Planning Memorandum.

The critical risk categories take into consideration both financial reporting and other than financial reporting risks, which categories would be common to most insurers and the typical impact of a risk category on the current and prospective financial solvency of an insurer. Additional risks beyond the critical risk categories are expected to be identified and reviewed through the examination process at the discretion of each examination team, as described in Section 2 of this Handbook.

To demonstrate that the examination has covered each of the relevant critical risk categories, the template below should be completed to demonstrate where in the exam file each critical risk area is addressed. This may be accomplished by providing reference to each individual risk statement that addresses each critical risk category. In situations where a particular critical risk category is not addressed by at least one risk statement, the exam team should provide reference to an explanation provided within the Examination Planning Memorandum.

Critical Risk Category Reporting Template

Risk Category	Description	Where Addressed
Valuation/ Impairment of Complex or Subjectively Valued Invested Assets	This category encompasses the valuation of particularly complex or subjectively valued investment holdings significant to the insurer, including assets that are hard-to-value, high-risk and/or subject to significant price variation, with a focus on current valuation. The likelihood of security impairment and determination of whether those impairments are other than temporary would also be an area to consider.	*Example Comment: See Risk 2.1 and Risk 3.1 on the Investments Matrix.*
Liquidity Considerations	This category encompasses the ability of the insurance company to meet current contractual obligations, which could include liquidating assets or obtaining adequate funding without incurring unacceptable losses. This category is most relevant for near-term cash flow needs that could impact the insurer (one to two years).	*Example Comment: This critical risk category was not deemed relevant. See a discussion in the EPM at A.5.3.*
Appropriateness of Investment Portfolio and Strategy	This category encompasses whether the insurer's investment portfolio and strategy are appropriately structured to support its ongoing business plan. Considerations may include elements of the ongoing investment strategy such as asset diversification, quality, maturities and risk/reward considerations, which could impact the insurer's vulnerability to future market fluctuations and impairments. For long-term lines of business in particular, these considerations would address asset adequacy testing/liability matching.	*Example Comment: See Risk 5 and Risk 6 on Exhibit V at A.7.3.*

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Risk Category	Description	Where Addressed
Appropriateness/ Adequacy of Reinsurance Program	This category encompasses the overall reinsurance strategy of the insurer, whether the strategy is appropriate to support its ongoing business plan and whether adequate coverage is in place to address the insurer's risk exposures (e.g., catastrophe risks, morbidity risk, etc.). Considerations may include the quality of reinsurance counterparties, types of coverage in place, associated limits, net retentions, concentration of reinsurance cessions, coverage periods, terms, affiliated agreements, etc.	
Reinsurance Reporting and Collectibility	This category encompasses whether all reinsurance amounts are properly accounted for and reported by the insurer. Considerations may include the existence and valuation (including collectibility) of reinsurance recoverable amounts and reserve credits. In addition, proper accounting and reporting/disclosure for risk transfer issues may be considered.	
Underwriting and Pricing Strategy/Quality	This category encompasses whether the insurer has appropriate underwriting, pricing and marketing practices (including premiums management) to meet its financial solvency needs. Considerations may include whether the insurer has established and implemented appropriate risk exposure limits and underwriting guidelines, whether the insurer is establishing adequate rates for the risks assumed under its policies and expense structure, and whether these strategies and practices are consistently applied across the insurer's distribution channels.	
Reserve Data	This category encompasses whether selected elements of the underlying data utilized by the actuary in reserve calculations are complete and accurate. Considerations may include claim or in-force data depending on the lines of business and reserving methodologies utilized by the insurer.	
Reserve Adequacy	This category encompasses the overall accuracy and adequacy of the reported reserves. Considerations may include the assumptions and methodologies used as well as the accuracy of reserve calculations. This category may apply to various forms of significant reserves carried by an insurer including life reserves, incurred but not reported (IBNR) reserves, case reserves, loss adjustment expense (LAE) reserves, policy reserves, premium deficiency reserves, etc.	
Related Party/Holding Company Considerations	This category encompasses transactions and agreements arising from relationships with affiliates that affect the insurer's ongoing solvency position. Considerations may include inequitable contract provisions, the impact of guarantees, contagion risks extending from holding company operations, intercompany tax issues, etc.	
Capital Management	This category encompasses the company's ability to assess, manage and maintain sufficient capital to sustain its business plan and solvency position. Considerations may also include a company's ability to forecast its capital needs and obtain additional capital, if necessary.	

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APPENDIX

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GLOSSARY

Accredited State	A state that meets the accreditation standards of the NAIC and has been awarded accredited status by the Financial Regulation Standards and Accreditation (F) Committee.
Analytical Procedures	Procedures which are typically used to determine whether a financial statement contains relationships and items that are unusual.
Annual Financial Reporting Model Regulation	See *Model Audit Rule.*
Attribute Testing	A method of testing which estimates the rate of occurrence of a specific attribute in a population.
Branded Risk Classifications	Nine classifications developed to assist examiners in categorizing identified risks to be reviewed on an examination. See Exhibit L.
Business Continuity Plan	A plan created by an insurer that identifies potential threats to its organization and presents plans to provide an effective response in order to ensure continuation of the insurer's operations.
Calculated Residual Risk	The risk that remains after considering the risk mitigation strategies that reduce the extent of inherent risk. This calculation is performed using a table located in Section 2 of the *Financial Condition Examiners Handbook*. Calculated residual risk may be adjusted based upon professional judgment (see *Judgmental Residual Risk*).
COBIT	Acronym for the IT Governance Institute's Control Objectives for Information and Related Technology. COBIT is one of the most widely recognized internal control standards for information technology management.
Control Testing	Procedures intended to provide assurance that internal processes and procedures are operating as prescribed.
Coordinated Examination	An examination that is performed by examiners from more than one state whereby the participating states share resources and allocate work among examiners. A coordinated examination can be conducted on either one insurer or a group of insurers and results in increased communication among states, more efficient use of resources and minimized duplication of work.
Corporate Governance	A system by which an insurer's board of directors and senior management monitor and oversee the activities, organizational structure and risk-management functions of an insurer.
Corporate Governance Assessment	An assessment of corporate governance, including management and the board of directors, that is completed during Phase 1 of a financial examination. It is required as part of the risk-focused process.
COSO	Acronym for Committee of Sponsoring Organizations. This acronym is generally used to refer to the COSO Integrated Framework of Internal Control, one of the most widely recognized internal control standards.
Critical Risk Categories	Ten categories that represent the most common areas of risk insurers face. The categories serve as the minimum standard for accreditation purposes and each category must be specifically addressed as part of an examination. See Exhibit DD.
Critical Thinking	See *Professional Judgment.*
Detail Testing	Testing performed in Phase 5 that is beyond or in addition to control testing and may include substantive and/or attribute testing.

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Detective Controls	Controls designed to detect an anomaly after it has occurred.
Exam Facilitator	The state/individual that assumes the primary leadership role in a coordinated group examination.
Examination Planning Memorandum	A document containing all significant examination planning considerations, which may include key-activities, examination goals, corporate governance, related parties, pending matters, use of work performed by others and materiality levels.
Examination Assertions	Underlying elements of financial statement accounts that the examiner uses to identify financial reporting risks.
Examination Planning Procedures Checklist	A list that details step-by-step the various components of planning a risk-focused examination. The examiner should initial and date as each step is completed. See Exhibit A.
Examination Planning Questionnaire	A document typically completed by company personnel in Phase 1, which contains procedures and questions that assist in gathering necessary planning information and obtaining an understanding of the insurer's organization. See Exhibit B.
Examination Report	A report that summarizes any significant findings of fact discovered during an examination.
External Audit Function	An independent, objective assurance activity conducted by a firm outside of an organization for the purpose of expressing an opinion as to whether the financial statements are free of material misstatement. An external audit is required annually by the *Model Audit Rule*.
Financial Exam Electronic Tracking System (FEETS)	Electronic system maintained by the NAIC and accessed by I-SITE through which group and individual examinations are called and tracked.
Financial Reporting Risk	The risk that an error will occur within the current financial statements of the insurer.
Full-Scope Examination	A financial exam in which the scope of the control testing and additional detail procedures to be performed during the examination is based on the implementation and documentation of the risk assessment procedures required under the *Financial Condition Examiners Handbook*.
Group Examination	A financial examination of multiple insurers that are part of an insurance holding company group.
Impact of Climate Change Risk	The impact of climate change risk may be identified as any significant change in the measures of climate over an extended period of time that includes major changes in relative temperatures, precipitation or wind patterns that occur over several decades or longer. It may include the effects from the increase in severity and occurrence of climate-change-related weather events (some may include, but are not limited to: thunderstorms, including severe hail and strong winds; tornadoes; hurricanes; windstorms; the aftermath of floods; heat waves; droughts; rise in sea level; forest fires; grass fires; and the resultant subsequent debilitating effects created by these events).
Individual Examination	A financial examination of one insurer.
Information Technology Planning Questionnaire	A document consisting of questions to be asked in the planning process of an information technology review. See Exhibit C.
Information Technology Review	The process of gaining an understanding and evaluating the effectiveness of an insurer's IT controls in mitigating common IT risks. The review consists of six steps. Steps 1–5 should be performed prior to the completion of planning the examination, and step 6 should be performed in conjunction with the remaining portion of the examination.
Information Technology Work Program	A framework designed to assist examiners in completing an information technology review. See Exhibit C Part Two.

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Inherent Risk	The risk of economic loss or inaccurate financial reporting before considering internal controls.
Insurer Profile Summary	An executive summary of an insurer's financial condition, risk profile, regulatory/action plans and other significant information necessary to quickly understand the insurer's current status. See an example template at Exhibit H.
Internal Audit Function	An independent, objective assurance activity usually performed by the company's employees that is designed to add value to and improve an organization's operations.
Internal Controls	See *Risk Mitigation Strategies*.
Judgmental Residual Risk	An adjustment to calculated residual risk based on an examiner's professional judgment.
Key Functional Activities	Significant business activities within an organization. These activities, along with their nature and level of risk, are used to ensure an appropriate exam scope.
Lead State	The state that takes the leadership role in coordinating the general regulatory activities, including examinations of a group of insurers, and efforts for particular insurance groups. Specific responsibilities of the *Lead State* can be found in Section 1 of the *Financial Condition Examiners Handbook*. Also refer to the *Financial Analysis Handbook* for additional information.
Letter of Representation	A letter from an insurer's management corroborating representations made to examiners during the course of the exam. See Exhibit I.
Likelihood of Occurrence	The probability that an event will occur that would prevent a process or activity from attaining its objectives. It is also one of the two elements of inherent risk.
Limited-Scope Examination	A financial exam which is limited to a review or examination of particular risk areas with a known or indicated concern as determined on a basis other than the implementation and documentation of the risk assessment procedures within the *Financial Condition Examiners Handbook*. It is narrowly focused on a specific area or areas of an insurer, such as a particular key activity or process, which require immediate attention. A limited-scope examination will result in issuance of an examination report as described in Section 1, Part X E of the Handbook.
Magnitude of Impact	The potential impact (financial or non-financial) or potential materiality of a risk if it occurs. It is also one of the two elements of inherent risk.
Management Letter	An optional exam workpaper that may be used to present results and observations noted during the exam to management and the board of directors that are not deemed necessary to include in the examination report.
Materiality	The dollar amount above which the examiner's perspective of an insurer's financial position will be influenced.
Model Audit Rule	An NAIC model regulation that is designed to help improve the surveillance of the financial condition of insurers by requiring an annual audit of financial statements and communication of internal control-related matters noted in an audit, as well as management's report of internal control over financial reporting (for insurers of a certain size). Also known as the *Annual Financial Reporting Model Regulation* (#205).
Multi-State Insurer	A company that is domiciled or chartered in one state and either licensed (traditional insurer), registered (risk retention group), qualified or accredited (reinsurer), eligible (surplus lines carrier) or operating in at least one other state.
Non-Accredited State	A state that is not currently accredited under the NAIC Financial Regulation Standards and Accreditation Program.
Other than Financial Reporting Risk	Business or strategic risk that is inherent in the insurer's operations and that has either an immaterial impact or no impact on the current financial statements but may have a solvency impact in the future.

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Overall Residual Risk	The extent of risk the examiner believes is retained within a specific identified risk after the consideration of risk-mitigation strategies/controls; also known as the final assessment of residual risk after considering both the calculated residual risk and judgmental residual risk.
ORSA	Acronym for Own Risk and Solvency Assessment which is a reporting requirement for insurers above a specified premium threshold and includes the insurer's assessment of its risk management framework, company risks and capital needs. See Section 1, Part XI.
Participating State	A state that does not lead, but participates in a group examination.
Planning Materiality (PM)	The examiner's judgment of materiality made during initial planning. It is used in developing the overall scope of the examination procedures.
Preventive Controls	Controls designed to prevent risks from occurring in a process.
Prioritization	Based on multiple applications (e.g., exam results, financial analysis), a qualitative and quantitative system of ranking insurers for the purpose of determining the nature and extent of solvency monitoring to be performed. For example, insurers with a higher priority may be examined more frequently and earlier in a particular cycle.
Professional Judgment	The ability and willingness to assess gathered information and make objective judgments on the basis of well-supported reasons; also known as *Critical Thinking*.
Prospective Risk	The risk associated with whether an insurer's current condition or processes provide indications of future solvency concerns.
Review and Approval Summary	A form that documents the performance of review requirements by the examiner-in-charge and other supervisory examiners. See Exhibit Q.
Risk Assessment Matrix	A tool developed to serve as a central location (lead sheet) for the documentation of risk assessment and testing conclusions. See Exhibit K.
Risk-Management Program	The procedures by which an insurer identifies, controls, monitors, evaluates and responds to its risks on an ongoing basis.
Risk-Mitigation Strategies	Procedures and policies that are utilized by insurers to mitigate inherent risk in key activities. This term is normally used when referring to Other than Financial Reporting risks. Generally, the term *Internal Controls* is used when referring to Financial Reporting risks.
Risk Statement	A statement associated with a key activity within the Risk Assessment Matrix describing an inherent risk identified by an examiner. This statement considers the answer to the question, "What could go wrong?" and is stated negatively.
Risk-Based Capital (RBC)	The minimum capital requirement an insurer must maintain. The calculation of RBC results in various Action and Control levels for insurer ratio results that fall within a certain percentage range.
Risk-Focused Surveillance Approach	A process of identifying significant risks, assessing and analyzing those risks, documenting the results of the analysis, and developing recommendations for how the analysis can be applied to the ongoing monitoring of the insurer.
Sarbanes-Oxley Act of 2002	A federal act that requires the external auditor to attest to management's assertion of adequate financial reporting internal controls.
Single State Insurer	A company that does not meet the definition of a *Multi-State Insurer*.
Substantive Testing	Testing performed for the purpose of expressing a conclusion about an account balance or set of transactions in terms of a dollar amount.
Summary Review Memorandum (SRM)	A document containing key issues and results of a risk-focused examination that should be shared with the Chief Examiner and the assigned analyst. See Exhibit AA.

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Supervisory Plan	A document that may be housed within the Insurer Profile Summary that contains information on the current status of an insurer, background on an insurer and a plan for ongoing solvency monitoring.
Tolerable Error	The materiality for a particular account balance. The amount of monetary error that can exist in a specific account balance without causing the financial statements as a whole to be materially misstated when added to errors in other account balances.

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