

The United States Insurance Financial Solvency Framework

The United States Insurance Financial Solvency Framework and Core Principles Executive Summary

Introduction

In June 2008, the NAIC's Solvency Modernization Initiative (SMI) was announced, with one of its objectives being an articulation of the United States Insurance Financial Solvency Framework and its Core Principles. The purpose of this document is to describe the framework for financial solvency insurance regulation in the United States and the core principles underlying it.

US Insurance Financial Solvency Framework

Ultimate regulatory responsibility for insurer insolvency rests with each state insurance department and the state insurance Commissioner (sometimes also known as the Administrator, Director or Superintendent of Insurance). State insurance departments are assisted by the NAIC, which is a voluntary organization of the Commissioners of the state insurance departments. The NAIC's overriding objective is to assist state insurance regulators by offering financial, actuarial, legal, computer, research and economic expertise to state regulators.

The starting point or context for the framework is the US Regulatory Mission which is to protect policyholders/claimants/beneficiaries first and foremost, while also facilitating an effective and efficient marketplace for insurance products. The U.S. meets preconditions required for effective regulation. These are primarily designed to ensure that regulators have appropriate regulatory authority over insurers, operate independently of insurer and political interference, maintain an adequate staff of sufficiently trained personnel, and treat confidential information appropriately.

The US insurance regulatory system is unique in the world in that (1) it relies on an extensive system of peer review, communication and collaborative effort that produce checks and balances in regulatory oversight; and (2) it includes a diversity of perspectives with compromise that leads to centrist solutions. These, in combination with a risk-focused approach to regulation, form the foundation for insurance regulation. As an example, the accreditation program relies on state certification by other regulators (i.e., peer review), requires risk-focused financial surveillance including on-site examinations, and requires solvency-related model laws, rules and guidelines that have been produced through consensus and collaboration.

Financial solvency core principles underlie the active regulation that exists today. A core principle, for purposes of this framework, is an approach, a process, or an action that is fundamentally and directly associated with achieving the mission. Seven core principles are identified for the US insurance regulatory system. These are discussed individually in the second part of this summary.

It is primarily through the states' adoption of NAIC model laws and model regulations, many of which are associated with accreditation, that the core principles operate through the regulatory system. Accreditation is a certification given to a state insurance department once it has demonstrated that it has met and continues to meet a wide range of legal, financial, functional and organizational standards. Fifty states and the District of Columbia are currently accredited. The purpose of the accreditation program is for state insurance departments to meet minimum, baseline standards of solvency regulation, especially with respect to regulation of multi-state insurers.

The implementation of the Accreditation program requires state adoption of model laws and regulations that incorporate Insurance Financial Solvency Standards and Monitoring. These can be categorized into Insurance Company Financial Solvency Requirements and Regulatory Monitoring Requirements. US Insurance Company Financial Solvency Requirements consist of specific state laws, guidelines, regulations, or rules that apply to insurers (e.g., filing of standardized financial statements that have been audited by a CPA). US Insurance Financial Solvency Regulatory Monitoring Requirements are laws, regulations and rules that must be adopted by the state and that apply to state regulators (e.g., insurers are required to be examined at least once every 5 years or more frequently as deemed appropriate). Additional regulatory monitoring is conducted by the NAIC through its surveillance processes (such as the Financial Analysis Solvency Tools (FAST) and the Financial Analysis Working Group).

US Insurance Financial Solvency Core Principles

Seven core principles have been identified for the US Insurance Financial Solvency Framework, as described below.

US Insurance Financial Solvency Core Principle 1: **Regulatory Reporting, Disclosure and Transparency**

Insurers are required to file standardized annual and quarterly financial reports that are used to assess the insurer's risk and financial condition. These reports contain both qualitative and quantitative information and are updated as necessary to incorporate significant common insurer risks.

US Insurance Financial Solvency Core Principle 2: **Off-site Monitoring and Analysis**

Off-site solvency monitoring is used to assess on an on-going basis the financial condition of the insurer as of the valuation date and to identify and assess current and prospective risks through risk-focused surveillance. The results of the off-site analysis are included in an insurer profile for continual solvency monitoring. Many off-site monitoring tools are maintained by the NAIC for regulators (such as FAST).

US Insurance Financial Solvency Core Principle 3:
On-site Risk-focused Examinations

US regulators carry out risk-focused, on-site examinations in which the insurer's corporate governance, management oversight and financial strength are evaluated, including the system of risk identification and mitigation both on a current and prospective basis. The reported financial results are assessed through the financial examination process and a determination is made of the insurer's compliance with legal requirements.

US Insurance Financial Solvency Core Principle 4:
Reserves, Capital Adequacy and Solvency

To ensure that legal obligations to policyholders, contract holders, and others are met when they come due, insurers are required to maintain reserves and capital and surplus at all times and in such forms so as to provide an adequate margin of safety. The most visible measure of capital adequacy requirements is associated with the risk based capital (RBC) system. The RBC calculation uses a standardized formula to benchmark specified level of regulatory actions for weakly capitalized insurers.

US Insurance Financial Solvency Core Principle 5:
Regulatory Control of Significant, Broad-based Risk-related Transactions/Activities

The regulatory framework recognizes that certain significant, broad-based transactions/activities affecting policyholders' interests must receive regulatory approval. These transactions/ activities encompass licensing requirements; change of control; the amount of dividends paid; transactions with affiliates; and reinsurance.

US Insurance Financial Solvency Core Principle 6:
Preventive and Corrective Measures, Including Enforcement

The regulatory authority takes preventive and corrective measures that are timely, suitable and necessary to reduce the impact of risks identified during on-site and off-site regulatory monitoring. These regulatory actions are enforced as necessary.

US Insurance Financial Solvency Core Principle 7:
Exiting the Market and Receivership

The legal and regulatory framework defines a range of options for the orderly exit of insurers from the marketplace. It defines solvency and establishes a

receivership scheme to ensure the payment of policyholder obligations of insolvent insurers subject to appropriate restrictions and limitations.

The United States Insurance Financial Solvency Framework

I. Objective and Overview

Objective of Paper

In June 2008, the NAIC’s Solvency Modernization Initiative (SMI) was announced. This initiative has several key objectives, including articulating an overview of the United States Insurance Financial Solvency Framework and its principles. The purpose of this paper is to describe the framework of the US Insurance Financial Solvency System and present a set of core financial principles underlying this framework.

Overview of Paper

This paper provides a description of the US Insurance Financial Solvency Framework that, while drawing upon ideas developed by the International Association of Insurance Supervisors (IAIS), goes beyond the IAIS in important, material ways. In particular, in the US regulatory system, ongoing collaborative regulatory peer review, regulatory checks and balances, and risk focused financial surveillance form the foundation of the regulatory process.¹ Also, the framework indicates that the US Insurance Financial Solvency Core Principles are embodied in the NAIC’s Financial Regulation Standards and Accreditation Program, which is a uniform program to which all states subscribe. Finally, included in this paper is a discussion of the US Insurance Financial Solvency Core Principles.

II. Presentation of US Insurance Financial Solvency Framework

Introduction

The state regulatory system in the United States has had over a 100 year history of solvency regulation. This system is comprised of state insurance departments (currently

¹ For purposes of this document, the term “regulator” refers to the ongoing supervision and oversight of entities under the authority of the state insurance department with the assistance of the NAIC. This terminology contrasts with the use of the term “regulator” in other parts of the world. In other parts of the world, regulator refers to the government agency responsible for developing regulations (e.g., Ministry of Finance or Treasury Department), while the term “supervisor” refers to the government officials responsible for overseeing insurance entities.

50 states, D.C. and 5 territories), and can best be described as a national system of state based regulation. The National Association of Insurance Commissioners (NAIC) assists regulators in a nonbinding, supplementary role.

Ultimate regulatory responsibility for insurer solvency rests with each state insurance department and the state insurance Commissioner.² In a free market economy, such as in the US, some insurer insolvencies are naturally expected. However, by following solvency standards, performing risk focused financial surveillance including on-site examinations, and enforcing solvency related insurance laws, regulations and guidelines, the state regulatory system has limited insurer insolvencies. A hallmark of the state regulatory system is its dynamic efforts to constantly improve the regulatory solvency system and adjust the system as needed, especially regarding inputs into the model used to determine asset, liability and capital requirements.

The NAIC is a voluntary organization of the chief insurance regulatory officials of the state insurance departments, and its overriding objective is to assist state insurance regulators in protecting consumers and helping maintain the financial stability of the insurance industry. The NAIC achieves this by offering financial, actuarial, legal, computer, research, market conduct, and economic expertise to state regulators. It is through the NAIC that insurers are provided the uniform platforms and coordinated systems they need in an ever-changing marketplace.

This paper, the US Insurance Financial Solvency Framework, has been created to document the processes utilized by regulators to monitor and assess the financial condition of insurers. It indicates how information flows to the regulator and how that information is used by regulators to take appropriate actions with respect to an insurer. Regulatory intervention, when it occurs, is generally focused on insurers where policyholders are most at risk (i.e., financially distressed insurers). Finally, the framework shows that a system of orderly exit from the market exists when insolvency becomes inevitable.

Regulatory Mission as Starting Point for Framework

The starting point or context for the US Insurance Financial Solvency Framework is the mission of insurance regulation in the United States. The mission or purpose of insurance regulation is:

US Insurance Regulatory Mission: To protect the interests of the policyholder and those who rely on the insurance coverage provided to the policyholder first and foremost, while also facilitating an effective and efficient market place for insurance products.

This mission has been used for years as the basis on which regulatory decisions have been made, including overall industry policy decisions and regulatory decisions for

² In some states the terms Director of Insurance or Superintendent of Insurance are used rather than Commissioner.

individual insurers. While the policyholder is the focal point of the mission, this mission is mindful that regulatory actions and decisions will have an impact on the operation of insurance markets and their efficiency. Because it is felt that “facilitating an effective and efficient market place for insurance products” is in the best interests of policyholders (e.g., cost efficiencies and product innovation), this is not considered to be a separate and distinct or secondary mission, but is considered to support a focus on the policyholder.

Preconditions for Effective Regulation

To achieve its mission the regulatory system must have the requisite authority. This requisite authority is comprised of the following elements: a legal basis, independence and accountability, adequate powers, financial resources, human resources, legal protection and confidentiality. These elements form the preconditions for effective insurance regulation:

Preconditions for Effective Regulation (Regulatory Authority)

The regulatory authority has adequate powers, legal protection and financial resources to exercise its functions and powers; is operationally independent from commercial and political interference in the exercise of its functions and powers; is ultimately accountable to the public; hires, trains, and maintains sufficient staff with high professional standards; and treats confidential information appropriately.

The US Insurance Financial Solvency Framework has been created over many years through the unified development of NAIC model laws, regulations, and other NAIC requirements. The adoption of these model laws within the individual states has created a legal framework for insurance regulation that is largely uniform throughout all of the states. To carry out the laws, regulations and other requirements, individual states have created insurance departments that are staffed with personnel that have the necessary knowledge and expertise. These state insurance departments act independently of insurers. In the course of pursuing their regulatory responsibilities, especially when solvency is at issue, regulators allow for the sharing of otherwise confidential documents with any state, federal agency or foreign country provided that the recipients are required, under their law, to maintain their confidentiality.

US Insurance Financial Solvency Regulation Foundations

Among the unique features of U.S. insurance regulation are (1) the extensive systems of peer review, communication and collaborative effort that produce checks and balances in regulatory oversight and (2) the diversity of perspectives with compromise that leads to centrist solutions. These, in combination with a risk-focused approach to regulation, form the foundation for insurance regulation in the U.S., as explained below.

The U.S. insurance market is comprised of thousands of small to large-sized insurance companies and groups, as well as conglomerates. To effectively regulate in such a large market, a risk-focused approach is utilized by state regulators. Under a risk-focused approach, attention is paid to the greatest risks faced by insurers and the insurance market. Explicit examples where this practice is applied are in on-site examinations and the ongoing analysis of nationally significant U.S. insurance groups (as explained later in this paper).

Mechanisms for peer review encourage effective regulatory and supervisory practices. The ongoing analysis of insurance groups provides an example of the checks and balances provided by peer review. Most regulators' interactions are collaborative and collegial. But situations arise where other state insurance commissioners can question the actions of another state insurance department, and, if necessary, pressure another state insurance department to act. This pressure is possible because regulators in other states have the power to examine all companies doing business in their state even though headquartered in other states and, in the worst case, to suspend their licenses to operate. Of course, free-flowing information among state regulators underlies this process; and the willingness of state insurance regulators to challenge and be challenged by other state regulators has developed over time in the U.S. as regulators work cooperatively with each other.

In regulation, there is a constant need to balance regulatory costs and benefits. Overregulation can impose unnecessary costs on consumers, while under-regulation (or de-regulation) can allow unnecessary harm to consumers and taxpayers. The balance between these two regimes is difficult to determine, but because of the multitude of diverse perspectives in the state U.S. regulatory system, it is less likely to end up at either extreme. Rather, the search for compromise tends to produce centrist solutions. Thus it is highly unlikely that a dogmatic move toward excessive deregulation (or overregulation) could occur in the state-based system.

The risk-focused approach, peer pressure/checks and balances, and ongoing collaboration based on consensus interact with each other to form the foundation of U.S. state insurance regulation. As an example of all of these approaches and processes, the accreditation program relies on state certification by other regulators, requires risk-focused financial surveillance including on-site examinations and requires enactment of solvency-related model laws, rules, and guidelines that have been reached through consensus and collaboration. This foundation makes insurance regulation in the U.S. unique in the world.

US Insurance Financial Solvency Core Principles and the Accreditation Program

For purposes of this paper, a core principle is an approach, a process or an action that is fundamentally and directly associated with achieving the mission. The following comprise the US Insurance Financial Solvency Core Principles.

Formulation of US Insurance Financial Solvency Core Principles

US Insurance Financial Solvency Core Principle 1:
Regulatory Reporting, Disclosure and Transparency

US Insurance Financial Solvency Core Principle 2:
Off-site Monitoring and Analysis

US Insurance Financial Solvency Core Principle 3:
On-site Risk-focused Examinations

US Insurance Financial Solvency Core Principle 4:
Reserves, Capital Adequacy and Solvency

US Insurance Financial Solvency Core Principle 5:
Regulatory Control of Significant, Broad-based Risk-related
Transactions/Activities

US Insurance Financial Solvency Core Principle 6:
Preventive and Corrective Measures, Including Enforcement

US Insurance Financial Solvency Core Principle 7:
Exiting the Market and Receivership

The Accreditation Program

It is primarily through the states' adoption of NAIC model laws and model regulations that the U.S. Insurance Financial Solvency Core Principles can function effectively within competitive market dynamics. Accreditation is a certification given to a state insurance department once it has demonstrated it has met and continues to meet a wide range of legal, financial, functional and organizational standards as determined by a committee of its peers. Fifty states and the District of Columbia are currently accredited.

The purpose of the accreditation program is for state insurance departments to meet minimum, baseline standards of solvency regulation especially with respect to regulation of multi-state insurers. The emphasis in the accreditation program and the processes it creates is on: (1) adequate solvency laws and regulations to protect consumers; (2) effective and efficient financial analysis and examination processes based on priority status of insurers; (3) cooperation and information sharing with other state, federal or foreign regulatory officials; (4) timely and effective action when insurance companies are identified as financially troubled or potentially troubled; (5) appropriate organizational and personnel practices; and (6) effective processes for company licensing and review of proposed changes in control. At the present time, for a state to be accredited, it must adopt certain laws, regulations or administrative practices that provide

appropriate regulatory authority and consumer protections in a variety of aspects of solvency regulation.³ Appendix 2 provides more details about accreditation.

To become accredited, the state must submit to a full on-site accreditation review. Depending on the results of the review, the state is accredited or it is not (i.e., a pass/fail system is used). To remain accredited, an accreditation review must be performed at least once every five years with interim annual reviews. If necessary management letter comments may be provided to the state and interim follow-up reviews may be required.

US Insurance Financial Solvency Standards and Monitoring

The implementation of the Accreditation Program requires state adoption of model laws and regulations that incorporate Insurance Financial Solvency Standards and Monitoring. These can be categorized into Insurance Company Financial Solvency Requirements and Regulatory Monitoring Requirements. Examples of each are provided below.

US Insurance Company Financial Solvency Requirements

U.S. Insurance Company Financial Solvency Requirements consist of specific state laws, guidelines, regulations, or rules which are applicable to insurers. These standards are documented in the NAIC's Financial Regulation Standards and Accreditation Program.

Examples of US Insurance Company Financial Solvency Requirements:

1. Insurers' submission of the annual and quarterly financial statements ("the annual statement" or "blank").
2. Most insurers' must annually submit a financial statement audited by a CPA, and their reserve estimates must be attested to by an actuary.
3. *Management's Report of Internal Control over Financial Reporting* is required of all insurers whose premiums exceed a predefined threshold.
4. Insurers are required to report the results of their risk-based capital calculation in the annual statement.⁴
5. Insurers must adhere to state minimum capital and surplus requirements.
6. Insurers must submit to examinations as deemed necessary by the regulator.
7. Each state has statutes requiring insurers to invest in a diversified investment portfolio both with respect to type of investment and the issuer.

³Specific standards must be complied with that relate to financial analysis, financial examinations, information sharing, and procedures for troubled insurers. States encourage professional development and establish organizational and personnel standards regarding minimum educational and experience requirements and must have the ability to attract and retain qualified personnel to obtain and maintain accreditation status.

⁴ The risk-based capital (RBC) system is discussed in more detail later in Core Principle 4.

8. There is a limitation on the amount on any single insured risk a property casualty insurer may underwrite.
9. Producer controlled insurers must meet special contract provisions, have an audit committee and separate reporting requirements.
10. For life and accident and health insurers, reserve requirements must adhere to statutory minimums and actuarial standards.
11. All insurers are required to report investment values in the financial statements in accordance with the *Purposes and Procedures Manual of the Securities Valuation Office*.
12. Insurers are required to use the NAIC's *Accounting Practices and Procedures Manual* and the *Annual Statement Blank and Instructions* in constructing their statutory financial statements.⁵
13. Reinsurance credit is governed by the NAIC Credit for Reinsurance Model Law, which imposes standards on allowing such credit.

US Insurance Financial Solvency Regulatory Monitoring Requirements

US Insurance Financial Solvency Regulatory Monitoring Requirements are laws, regulations and rules that must be adopted by the state and that are applicable to state regulators. Many of these solvency standards are requirements of the accreditation program.

Examples of US Insurance Financial Solvency Regulatory Monitoring Requirements:

1. Regulators are required to examine an insurer at least once every five years or more frequently as deemed appropriate and have the authority to examine a company at any time it is deemed necessary by the Commissioner.
2. If a potential capital deficiency is signaled by the RBC result, a ladder of intervention exists under which regulators are required to undertake certain actions depending on the degree of deficiency. This intervention can vary from requiring insurers to file a plan of corrective action to regulatory takeover of the insurer.
3. Certain transactions require approval (e.g., transactions among affiliated insurers).

Additionally, regulatory monitoring includes other surveillance processes such as:

1. NAIC's Financial Analysis Solvency Tools (FAST). FAST encompasses a

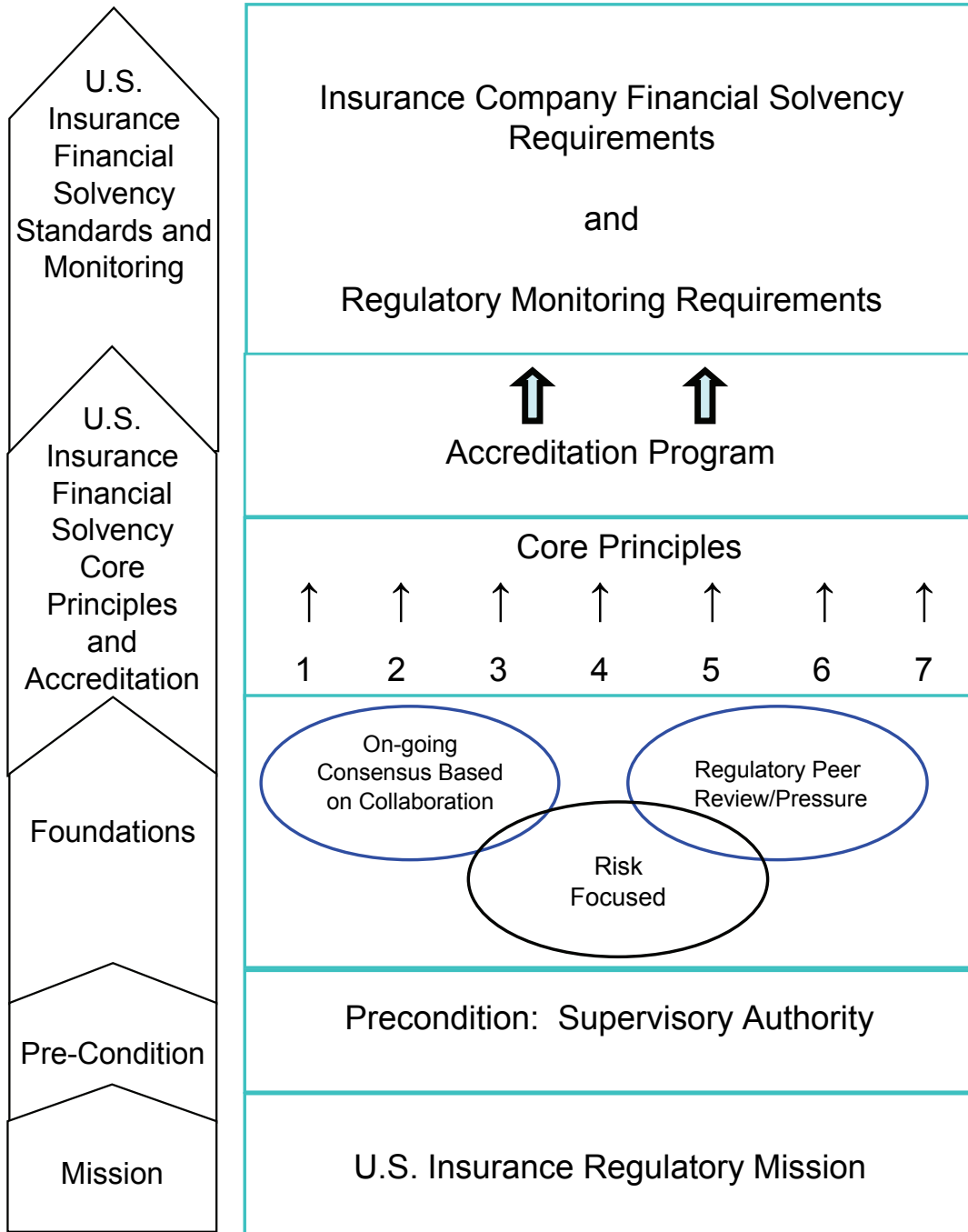
⁵For example, these tools restrict discounting property and casualty reserves, and specific tables approved by regulators are required to establish reserves for various life insurance products. Only certain assets (admitted assets) are allowed to be considered as statutory assets. There are significant reinsurance requirements that take into account the ability of reinsurers to pay. One of these requirements includes statutory accounting requirements for taking a reserve credit for reinsurance.

wide-ranging review/testing system that includes (but is not limited to): (1) a scoring system based on over 20 financial ratios; (2) the Analyst Team System (ATS) (an automated review process that creates a national prioritization system using statistical analysis, a scoring system, and RBC to assign review levels for insurers); (3) RBC trend test; and (4) loss reserve projection tools. Insurers deemed to be performing poorly from the FAST analysis are reviewed by experienced analysts to determine the degree of financial distress present, if any. Insurers deemed to be in financial distress are prioritized by the degree of financial distress and the results are communicated to the state insurance departments in which the insurer is licensed.⁶

2. Nationally significant insurers are reviewed every quarter and those that appear to be performing poorly are prioritized for more detailed analysis by a group of experienced, seasoned financial regulators (i.e., the Financial Analysis Working Group (FAWG)). The FAWG committee confirms/informs the lead state regulator of problems with insurers in their state and can assert peer pressure on the regulator to intervene to address the troubled insurer's situation.

⁶ The domestic regulator gives all insurers a priority status which is a driver for the level of risk focused surveillance an insurer receives.

Diagram of U.S. Insurance Financial Solvency Framework



III. Overview of US Insurance Financial Solvency Core Principles

This section provides a brief discussion of each US Insurance Financial Solvency Core Principle.

US Insurance Financial Solvency Core Principle 1: Regulatory Reporting, Disclosure and Transparency

US regulators receive required financial reports from insurers on a regular basis that are the baseline for continual assessment of the insurer's risk and financial condition. Standardized financial reporting is used in the financial statements to ensure comparability of results among insurers. To address concerns with specific companies or issues, supplemental data is requested in addition to the standardized data, and these data may be requested on a more frequent basis from specific companies. The standardized format is updated as necessary to incorporate significant, common insurer risks.

The financial reports filed with the regulator include the set of comprehensive financial statements known collectively as the Annual Statement. Also included in the financial reporting requirements is the filing of quarterly financial statements. To increase comparability and consistency in reporting, the insurer is required to complete the annual and quarterly statements in accordance with NAIC instructions, which provide specific direction on how the statements are to be completed. In addition, NAIC statutory accounting principles are used as the baseline accounting requirements in all financial reports.

The financial reports also include numerous qualitative disclosures, each of which are designed to identify potential risks of the insurer. These include but are not limited to general and specific interrogatories, the notes to financial statements, management's discussion and analysis, an actuarial opinion, and an annual audit opinion from an independent certified public accountant. Other standardized reports are filed with the regulator throughout the year that identifies more specific risks (e.g., investment risk interrogatories).

The information contained in all of these financial reports is designed to be thorough, so that sufficient information is provided to the regulator to continually monitor and identify specific risks faced by the insurer.⁷ The financial reports are used extensively in

⁷Carrying value, fair value, credit quality designation and other pertinent information are disclosed for every applicable investment held by the insurer; and the detailed disclosures are categorized by asset type, e.g., issuer obligations vs. collateralized mortgage obligations and other structured securities. Similarly, each reinsurance contract is disclosed along with various amounts payable or receivable, grouped by assumed vs. ceded insurance, and categorized by type of entity, e.g., affiliated or mandatory pool. Property and casualty lines of business, which use a principles-based reserving approach, are disclosed in great detail regarding losses and loss expenses, including loss reserve triangles and historical development of various aspects of reserves, e.g., bulk and incurred but not reported (IBNR) reserves.

regulatory solvency monitoring, including on-site examinations and off-site monitoring. That is, the regulatory reports feed into the off-site monitoring analysis and provide a foundation for on-site examinations. In turn, off-site monitoring and examinations are used to determine whether additional or more frequent reporting may be required of an insurer.

The annual and quarterly statements are electronically captured by the NAIC in two formats: data tables available for querying and automated analytical tool usage; and PDF files that are publicly available and intended to provide consumers with direct access to financial information submitted by any insurer.⁸

US Insurance Financial Solvency Core Principle 2: Off-site Monitoring and Analysis

US regulators and the NAIC conduct off-site risk-focused analysis of insurers.

The primary purpose of off-site solvency monitoring is to assess on an on-going basis the financial condition of the insurer as of the valuation date and to identify and assess current and prospective risks through risk-focused surveillance, the results of which are included in an insurer profile for continual solvency monitoring. To accomplish this task, state insurance regulators conduct detailed financial analysis on a quarterly basis using regulatory financial reports, financial tools and other sources of information. Two key sources of information are the results of the most recently completed independent certified public accountant (CPA) audit report and the results of the most recent on-site regulatory financial examination.⁹ Other sources utilized in the analysis include SEC filings, corporate reports, financial statements of ultimate controlling individual/corporation or reinsurers, market conduct reports, rate and policy form filings, consumer complaints, independent rating agency reports, correspondence from agents and insurers, and business media.

Off-site monitoring includes follow up on risks identified during the previous quarter's analysis and the most recent on-site examination. Otherwise, state insurance departments generally prioritize the review of their domiciliary insurers based on a system of financial ratios, other screening tools and criteria that are both qualitative and quantitative in form. When insurers with anomalous results (e.g., insurers experiencing significant variations or negative financial results) that may impact financial solvency are identified, regulators will allot necessary resources and prioritize further analysis of these insurers (relative to other non-priority insurers). The results of the ongoing financial analysis are then used to help prioritize and provide focus to future quarterly off-site monitoring activities (potentially increasing monitoring activities to a monthly or weekly basis) and any on-site examination efforts.

⁸ Where an insurer's accounting differs from the baseline NAIC statutory accounting principles, the impact to capital and surplus as well as net income is disclosed in the notes to financial statements.

⁹ The CPA audit report attests to the fair presentation of the financial statements on an annual basis to allow sufficient reliance upon the insurer's financial reports utilized in all off-site monitoring (see Principle 3).

Many tools used by state regulators are maintained by the NAIC and have been created as regulator only tools. These tools are designed to provide an integrated approach to screening and analyzing the financial condition of insurers and are referred to collectively as FAST (i.e., Financial Analysis Solvency Tools). The tools include a comprehensive handbook that sets forth an overall analysis process to be used, as well as more specific financial analysis/tests that utilize the data provided in insurers' financial reports to identify risks or anomalies.

In addition to the NAIC tools described above, the NAIC's Financial Analysis Working Group (FAWG) performs its own analysis of the financial condition of each nationally significant insurer or group each quarter, as well as other insurers or areas posing unique risks identified during a given period, looking not only at statutory financial statements but at other public information, including such financial market metrics as the market's valuation and rating of the insurer's debt and short sales of the insurer's stock. The FAWG does not meet publicly and does not share its deliberations with the general public due to its discussion being focused on the financial condition of individual insurers. This group also monitors industry trends in various risk areas.

**US Insurance Financial Solvency Core Principle 3:
On-Site Risk-focused Examinations**

US regulators carry out risk-focused, on-site examinations in which the insurer's corporate governance, management oversight and financial strength are evaluated, including the system of risk identification and mitigation. Through the examination, the reported financial results are assessed and a determination is made of the insurer's compliance with legal requirements.

Insurers are subject to a full-scope financial examination at least once every 5 years.¹⁰ However, based upon the results of off-site monitoring, regulators may place a higher priority on insurers which pose a financial risk and, therefore, conduct on-site examinations more frequently. These examinations may be limited to a review of a specific risk, as long as a full scope exam is conducted at least once every 5 years.

The primary purpose of an on-site examination is to allow state regulators to evaluate and assess the solvency of insurers as of the valuation date and to develop a forward-looking view of an insurer's risks and its risk management practices. This approach permits a direct and specific focus on the areas of greatest risk to an insurer. The results of the off-site analysis are also utilized in identifying areas of concern and key functional activities to be reviewed.

Through the on-site examination, corporate governance practices and processes that are in place to identify and mitigate risk are reviewed and assessed, including, among other things, the function and effectiveness of the board of directors and management, the adequacy of risk management (enterprise risk management), monitoring and management

¹⁰ In some states the period is three years.

information systems. All significant inherent risks faced by the insurer are identified and assessed, whether they relate to financial reporting issues or to business and operational issues. After risks have been identified, the examiner is required to identify and assess the internal control processes that mitigate each identified risk. Controls are assessed by considering both their current and prospective design and operating effectiveness. The results of these on-site examination processes also provide regulators an indication of the reliability of the insurer's financial reports utilized in off-site analysis.

To prevent duplicative examination efforts by regulators for insurers writing in multiple states, regulators may rely on the exam work of the NAIC accredited domiciliary state. Additionally, for large insurance holding company groups, regulators are encouraged to coordinate their examinations of individual entities by following a lead state concept, thereby allowing the pooling of resources to complete one coordinated exam for the insurer group.

In conjunction with both the on-site examinations and off-site monitoring, regulators review insurer compliance with laws and regulations. Laws and regulations can vary by state.¹¹ Some states will combine their review of compliance with market conduct activities with a financial on-site exam.

US Insurance Financial Solvency Core Principle 4: Reserves, Capital Adequacy and Solvency

To ensure that legal obligations to policyholders, contract holders and others are met when they come due, insurers are required to maintain reserves and capital and surplus at all times and in such forms so as to provide an adequate margin of safety.

Accounting standards, risk-based capital requirements, minimum statutory reserves and state-specific minimum capital requirements form the backbone of the reserve and capital adequacy requirements. Conservatism is a pervasive concept in specification of these requirements. As an example, conservatism is one of the foundations of the statutory accounting system.¹² Conservative statutory accounting reporting provides a reasonable level of assurance that an insurer's resources are adequate to meet its policyholder obligations at all times. Other NAIC standards are designed with the same conservatism principle (e.g., model investment laws, credit for reinsurance laws, etc.).

The most visible measure of capital adequacy requirements is associated with the risk based capital (RBC) system. The risk-based capital calculation uses a standardized

¹¹ These laws typically include, but are not limited to, compliance with investment statutes and regulations regarding types of permissible investments and diversification and liquidity of investments, compliance with (minimum) reserving standards and minimum capital and surplus requirements (including RBC), and the restriction of certain reinsurance activities.

¹² Statutory accounting practices stress measurement of the ability to pay claims of insurers in the future, while generally accepted accounting principles (GAAP) stress measurement of earnings of a business from period to period, and the matching of revenues and expenses for the measurement period. Source: Preamble of the NAIC *Accounting Practices and Procedures Manual*.

formula to benchmark specified level of regulatory actions for weakly capitalized insurers. A significant portion of the risk-based formula is derived from the annual statement, which is based upon statutory accounting. The RBC amount explicitly considers the size and risk profile of the insurer.¹³ The risk-based capital calculation provides for higher RBC charges for riskier assets or for riskier lines of business so that more capital is needed as a result. Although risk-based capital results indicate when an insurer's capital position is weak or deteriorating, a ladder of intervention levels exists within the RBC system. Thus, regulators have the authority to require insurers to take some action or the regulator may have the authority to take action with respect to an insurer when the capital level falls within certain threshold amounts that are above the minimum capital requirement. The degree of action depends upon the relative capital weakness as determined by the RBC result and the existence of any mitigating or compounding issues.

States maintain fixed minimum capital requirements (statutes) relating to incorporation and licensing within the particular state that must also be met. Further, the state has the authority to require additional capital and surplus based upon the type, volume, and nature of the insurance business transacted.

Insurers have conservative minimum reserve requirements in addition to capital requirements. Thus, the effect of having both reserves and capital adequacy requirements means that (1) policyholder obligations are covered by enough resources to meet most future economic scenarios, and (2) there are enough resources so that an adverse trend can be detected in time for the regulator to suggest/take corrective action.

**US Insurance Financial Solvency Core Principle 5:
Regulatory Control of Significant, Broad-based Risk-related Transactions/Activities**
The regulatory framework recognizes that certain significant, broad-based transactions/activities affecting policyholders' interests must receive regulatory approval.

Certain significant, broad-based transactions/activities of insurers that affect risk are not part of the day-to-day routine of underwriting and issuing insurance and/or have broad social and equity consequences. To control these risks, regulatory approval of these transactions/activities may be required. Many of these transactions are also reviewed during the off site monitoring or the on-site examination process to assess insurer compliance. These transactions/activities encompass licensing requirements; change of control; the amount of dividends paid; transactions with affiliates; and reinsurance as explained below.

Licensing Requirements: An insurer must be licensed before it can operate in a state. The regulator sets the criteria for licensing, and these criteria are clear, objective and public. Regulators assess the license application; this assessment consists of a review of the ownership structure, quality and history of

¹³ The factors used in the formula are based on considerable research and reflect industry loss experience.

management, internal controls, and projected financial condition. Applicants that do not meet the criteria do not obtain a certificate of authority and/or license to conduct the business of insurance.¹⁴

Change in Control: Notification is required for changes in ownership or control. No transaction involving a change in ownership or control can be completed unless regulatory approval is granted or waived. The regulator bases the approval or rejection decision on financial statements and other relevant information filed with the regulator.

Dividends: The regulator requires prior notice of all stockholder dividends and dividends in excess of a predefined standard (extraordinary dividends) must be filed for approval. Extraordinary dividends cannot be paid until regulatory approval is granted.¹⁵

Transactions with Affiliates: The regulator requires notice for transactions with affiliates and has the authority to reject the transaction. These transactions include, but are not limited to, various intercompany cost sharing arrangements, guarantees, reinsurance, asset purchase and disposal agreements, and tax allocation agreements between the insurer and its affiliates.

Reinsurance: Reinsurance transactions are subject to regulatory review and approval, with the result that some reinsurers may be required to post collateral.

US Insurance Financial Solvency Core Principle 6: Preventive and Corrective Measures, Including Enforcement

The regulatory authority takes preventive and corrective measures that are timely, suitable and necessary to reduce the impact of risks identified during on-site and off-site regulatory monitoring. These regulatory actions are enforced as necessary.

If significant solvency risks are identified as being improperly mitigated such that the insurer is in a hazardous financial condition, the regulator may take corrective or preventive measures including, but not limited to: requiring the insurer to provide an updated business plan in order to continue to transact business in the state; requiring the insurer to file interim financial reports; limiting or withdrawing the insurer from certain investments or investment practices; reducing, suspending or restricting the volume of business being accepted or renewed by the insurer; ordering an increase in the insurer's capital and surplus; ordering the insurer to correct corporate governance practice

¹⁴ Effective January 1, 2012, the Accreditation Program will incorporate new standards related to company licensure and change in ownership. These standards require that state insurance departments have sufficient, qualified resources to review applications in a timely manner and have appropriate procedures to properly analyze the application.

¹⁵ This is a general requirement, but individual state requirements may vary. For example, not all states require approval of ordinary dividends. Some states require that all stockholder dividends be approved.

deficiencies; requiring a replacement of senior management; and seeking a court order to place the company under conservation, rehabilitation, or liquidation;

In addition to the corrective measures that can be taken when the insurer is determined to be in a hazardous financial condition, under the RBC system, regulators have the authority and statutory mandate to take preventive and corrective measures that vary depending on the capital deficiency indicated by the RBC result. The broad authority for determining if an insurer is considered to be in a hazardous financial condition is an important part of the US system, and allows for more precision within the RBC calculation.

These preventive and corrective measures are designed to provide for early regulatory intervention to correct problems before insolvencies become inevitable, thereby minimizing the number and adverse impact of insolvencies.

US Insurance Financial Solvency Core Principle 7:

Exiting the Market and Receivership

The legal and regulatory framework defines a range of options for the orderly exit of insurers from the marketplace. It defines solvency and establishes a receivership scheme to ensure the payment of policyholder obligations of insolvent insurers subject to appropriate restrictions and limitations.

Receivership laws provide measures for regulators to attempt to prevent insolvencies, minimize losses and provide protection for claimants (including policyholders) before an insolvency and/or if an insurer is found to be insolvent. Options considered by regulators as possible alternatives to insolvency include mergers, acquisitions, reinsurance arrangements, non-renewal of part or all of the insurer's book of business, and the viability of allowing the insurer to be placed in run-off mode under its own management. When insolvency cannot be prevented, receivership laws give some priority to the provision of benefits to claimants, including policyholders, or the payment of claims arising under policies. State guaranty associations have been established to protect policyholders, claimants and beneficiaries against financial losses due to insurer insolvencies. Fundamentally, the purpose of an insolvency guaranty law/association is to cover an insolvent insurer's financial obligations, within statutory limits, to policyholders, annuitants, beneficiaries and third-party claimants.

Appendix 1

List of relevant Model Laws, Rules, Regulations and Working Groups by US Insurance Financial Solvency Core Principle

US Insurance Financial Solvency Core Principle 1: Regulatory Reporting, Disclosure and Transparency

NAIC *Accounting Practices and Procedures* Manual
NAIC Blanks Working Group
Statutory Accounting Practices Working Group
EAI Working Group
Financial Analysis Handbook Working Group
NAIC's Standard Valuation Law
Actuarial Opinion and Memorandum Regulation
Part B of the Financial Regulation Standards and Accreditation Program
NAIC Annual Financial Reporting Model Regulation (#205)
Securities Valuation Purposes and Procedures Manual.
NAIC *Annual Statement Instructions*
NAIC's *Purposes and Procedures of the Securities Valuation Office*
NAIC *Valuation of Securities* Manual
Business Transacted with Producer Controlled Property/Casualty Insurance Act (#325)

US Insurance Financial Solvency Core Principle 2: Off Site Monitoring and Analysis

Analyst Team System
FAST
NAIC *Accounting Practices and Procedures* Manual
NAIC Annual Financial Reporting Model Regulation (#205)
NAIC Model Insurance Holding Company System Regulatory Act
NAIC Actuarial Opinion and Memorandum Model Regulation (#822)
NAIC Blanks Working Group
Part B of the Financial Regulation Standards and Accreditation Program
Business Transacted with Producer Controlled Property/Casualty Insurance Act (#325)
Financial Analysis Handbooks (as reviewed and updated by the Financial Analysis Handbook Working Group)

**US Insurance Financial Solvency Core Principle 3:
On-site Risk-focused Examinations**

Model Law on Examinations (#390)
Financial Condition Examiners Handbook (Examiners Handbook)
NAIC Annual Financial Reporting Model Regulation (#205)
Insurance Company Holding Company Regulatory Act
NAIC Investment of Insurers Model Act (Defined Limits Version)
NAIC Derivative Instruments Model Regulation
NAIC's Investment of Insurers Model Act (#280)
NAIC Actuarial Opinion and Memorandum Model Regulation (#822)
Part B, Financial Regulation Standards and Accreditation Program

**US Insurance Financial Solvency Core Principle 4:
Capital Adequacy and Solvency**

NAIC Risk-Based Capital for Insurers Model Act
NAIC Risk-Based Capital for Health Organizations Model Act
NAIC *Accounting Practices and Procedures* Manual
NAIC Financial Regulation Standards and Accreditation Program (Capital and Surplus Requirements)
NAIC *Annual Statement Instructions*
NAIC *Risk-Based Capital Report Including Overview and Instructions*
Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition (#385)
NAIC Credit for Reinsurance Model Law (#785)

**US Insurance Financial Solvency Core Principle 5:
Regulatory Control of Significant, Broad-based Risk-related Transactions/Activities**

Interest Maintenance Reserve calculation (life insurers)
NAIC Investment of Insurers Model Act (#280 and 283)
Actuarial Opinion and Memorandum Regulation
Business Transacted with Producer Controlled Property/Casualty Insurance Act (#325)
Part A, Financial Regulation Standards and Accreditation Program
Insurance Holding Company Regulatory Act

**US Insurance Financial Solvency Core Principle 6:
Preventive and Corrective Measures, Including Enforcement**

NAIC *Troubled Insurance Company Handbook*
NAIC's Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition (#385)

Risk-based Capital (RBC) for Insurers Model Act
NAIC Administrative Supervision Model Act
Part A, Financial Regulation Standards and Accreditation Program

**US Insurance Financial Solvency Core Principle 7:
Exiting the Market and Receivership**

NAIC *Troubled Insurance Company Handbook*
NAIC's Rehabilitation and Liquidation Model Act
Part A, Financial Regulation Standards and Accreditation Program

Appendix 2

Requirements for Accreditation

The Standards have been divided into three major categories: laws and regulations (Part A); regulatory practices and procedures (Part B); and organizational and personnel practices (Part C).

Part A: Laws and Regulations

Preamble

The purpose of the Part A: Laws and Regulations Standards is to assure that an accredited state has sufficient authority to regulate the solvency of its multi-state domestic insurance industry in an effective manner. The Part A standards are the product of laws and regulations that are believed to be basic building blocks for sound insurance regulation. A state may demonstrate compliance with a Part A standard through a law, a regulation, an established practice which implements the general authority granted to the state, or any combination of laws, regulations or practice, which achieves the objective of the standard.

The Part A standards apply to traditional forms of “multi-state domestic insurers.” This scope includes life/health and property/casualty/liability insurers and reinsurers that are domiciled in the accredited state and licensed, accredited or operating in at least one other state. This scope also includes insurers that are domiciled in the accredited state and operating or accepting business on an exported basis in at least one other state as excess and surplus lines insurers or as risk retention groups; except that the term does not include risk retention groups incorporated as captive insurers. It also does not include those insurers that are licensed, accredited or operating in only their state of domicile but assuming business from insurers writing that business that is directly written in a different state. The terms “insurer” and “insurers” used in the Part A standards fall within the definition of “multi-state domestic insurers.” For the purpose of this definition, the term “state” is intended to include any NAIC member jurisdiction, including U.S. territories.

1. Examination Authority

The Department should have authority to examine companies whenever it is deemed necessary. Such authority should include complete access to the company’s books and records and, if necessary, the records of any affiliated company, agent, and/or managing general agent. Such authority should extend not only to inspect books and records but also to examine officers, employees, and agents of the company under oath when deemed necessary with respect to transactions directly or indirectly related to the company under examination. The NAIC Model Law on Examinations or substantially similar provisions shall be part of state law.

2. Capital and Surplus Requirement

The Department should have the ability to require that insurers have and maintain a minimum level of capital and surplus to transact business. The Department should have the authority to require additional capital and surplus based upon the type, volume and nature of insurance business transacted. The Risk Based Capital (RBC) for Insurers Model Act or provisions substantially similar shall be included in state laws or regulations.

3. NAIC Accounting Practices and Procedures

The Department should require that all companies reporting to the Department file the appropriate NAIC annual statement blank, which should be prepared in accordance with the NAIC's instructions handbook and follow those accounting procedures and practices prescribed by the NAIC's *Accounting Practices and Procedures Manual*, utilizing the version effective January 1, 2001 and all subsequent revisions adopted by the Financial Regulation Standards and Accreditation (F) Committee.

4. Corrective Action

State law should contain the NAIC's Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in a Hazardous Financial Condition or a substantially similar provision, which authorizes the Department to order a company to take necessary corrective action or cease and desist certain practices that, if not corrected, could place the company in a hazardous financial condition.

5. Valuation of Investments

The Department should require that securities owned by insurance companies be valued in accordance with those standards promulgated by the NAIC's Securities Valuation Office. Other invested assets should be required to be valued in accordance with the procedures promulgated by the NAIC's Financial Condition (E) Committee.

6. Holding Company Systems

State law should contain the NAIC Model Insurance Holding Company System Regulatory Act or an Act substantially similar, and the Department should have adopted the NAIC's model regulation relating to this law.

7. Risk Limitation

State law should prescribe the maximum net amount of risk to be retained by a property and liability company for an individual risk based upon the company's capital and surplus. This limitation should be no larger than 10% of the company's capital and surplus.

8. Investment Regulations

State statute should require a diversified investment portfolio for all domestic insurers both as to type and issue and include a requirement for liquidity. Foreign companies should be required to substantially comply with these provisions.

9. Liabilities and Reserves

State statute should prescribe minimum standards for the establishment of liabilities and reserves resulting from insurance contracts issued by an insurer; including life reserves, active life reserves, and unearned premium reserves, and liabilities for claims and losses unpaid and incurred but not reported claims. The NAIC's Standard Valuation Law and Actuarial Opinion and Memorandum Regulation or substantially similar provisions shall be in place.

10. Reinsurance Ceded

State law should contain the NAIC Model Law on Credit for Reinsurance, the NAIC's Credit for Reinsurance Model Regulation and the NAIC Life and Health Reinsurance Agreement Model Regulation or substantially similar laws.

11. CPA Audits

State statute or regulation should contain a requirement for annual audits of domestic insurance companies by independent certified public accountants, based on the NAIC's Annual Financial Reporting Model Regulation.

12. Actuarial Opinion

State statute or regulation should contain a requirement for an opinion on reserves and loss and loss adjustment expense reserves by a qualified actuary or specialist on an annual basis for all domestic insurance companies.

13. Receivership

State law should set forth a receivership scheme for the administration, by the insurance commissioner, of insurance companies found to be insolvent as set forth in the NAIC's Insurer Receivership Model Act.

14. Guaranty Funds

State law should provide for a regulatory framework such as that contained in the NAIC's model acts on the subject, to ensure the payment of policyholders' obligations subject to appropriate restrictions and limitations when a company is deemed insolvent.

15. Filings with NAIC

State statute, regulation or practice should mandate filing of annual and quarterly statements with the NAIC in a format acceptable to the NAIC except that states may exempt from this requirement those companies that operate only in their state of domicile.

16. Producer Controlled Insurers

States should provide evidence of a regulatory framework, such as that contained in the NAIC's model law for Business Transacted with Producer Controlled Property/Casualty Insurer Act or similar provisions.

17. Managing General Agents Act

States should provide evidence of a regulatory framework, such as that contained in the NAIC's Managing General Agents Model Act or similar provisions.

18. Reinsurance Intermediaries Act

States should provide evidence of a regulatory framework, such as that contained in the NAIC's Reinsurance Intermediary Model Act or similar provisions.

(Note: If a state can provide evidence that none of the entities contemplated in above standards 14, 16, 17 or 18, is either present or allowed to operate in the state, it will not need to demonstrate compliance with that standard.)

Part B: Regulatory Practices and Procedures

Preamble

The purpose of Part B is to identify base-line regulatory practices and procedures required to supplement and support enforcement of the states' financial solvency laws in order for the states to attain substantial compliance with the core standards established in Part A. Part B identifies standards that are to be applied in the regulation of all forms of multi-state insurers.

Part B sets out standards required to ensure adequate solvency regulation of multi-state insurers. Each state must make an appropriate allocation of its available resources to effectively address its regulatory priorities. In addition to a domestic state's examination and analysis activities, other checks and balances exist in the regulatory environment. These include other states' regulation of licensed foreign companies, the appropriate application of FAST and IRIS ratios, the analyses by NAIC's staff, the NAIC Financial Analysis Working Group, the NAIC Analyst Team System project, and, to some extent, the evaluation by private rating agencies.

The scope of Part B is broader than the scope of Part A. "Multi-state insurer" as used in Part B encompasses all forms of insurers domiciled or chartered in the accredited state and licensed, registered, accredited or operating in at least one other state. This scope also includes insurers that are domiciled in the accredited state and operating or accepting business on an exported basis in at least one other state as excess and surplus lines insurers. It does not include those insurers that are licensed, accredited or operating in only their state of domicile but are assuming business from insurers writing that business that is directly written in a different state. The term "insurer" in Part B includes traditional insurance companies as well as, for instance, health maintenance organizations and health service plans, captive risk retention groups, and other entities organized under other statutory schemes. Although this scope includes risk retention groups organized as

a captive insurer, it does not include any other type of captive insurer. While the unique organizational characteristics of some of these entities may require specialized laws, their multi-state activity demands solvency oversight that employs the base-line regulatory practices and procedures identified in Part B. For purposes of this definition, the term “state” is intended to include any NAIC member jurisdiction, including U.S. territories.

The accreditation program recognizes that complete standardization of practices and procedures across all states may not be practical or desirable because of the unique situations each state faces. States differ with respect to staff and technology resources that are available as well as the characteristics of the domestic industry regulated. For example, states may choose to emphasize automated analysis over manual or vice versa. Reliable results may be obtained using alternative, yet effective, financial solvency oversight methodologies. The accreditation program should not emphasize form over substance in its evaluation of the states’ solvency regulation.

(NOTE: FRSAC has adopted Review Team Guidelines that provide detailed guidance to the review teams regarding how compliance with the Part B, Regulatory Practices and Procedures Standards should be assessed. These guidelines can also assist states in preparing for the accreditation review of their Department.)

1. Financial Analysis

a. Sufficient Qualified Staff and Resources

The Department should have the resources to review effectively on a periodic basis the financial condition of all domestic insurers.

b. Communication of Relevant Information to/from Financial Analysis Staff

The Department should provide relevant information and data received by the Department, which may assist in the financial analysis process to the financial analysis staff and ensure that findings of the financial analysis staff are communicated to the appropriate person(s).

c. Appropriate Supervisory Review

The Department’s internal financial analysis process should provide for appropriate supervisory review and comment.

d. Priority-Based Analysis

The Department’s financial analysis procedures should be priority-based to ensure that potential problem companies are reviewed promptly. Such a prioritization scheme should utilize appropriate factors as guidelines to assist in the consistent determination of priority designations.

e. Appropriate Depth of Review

The Department’s financial analysis procedures should ensure that domestic insurers receive an appropriate level or depth of review commensurate with their financial strength and position.

f. Documented Analysis Procedures

The Department should have documented financial analysis procedures and/or guidelines to provide for consistency and continuity in the process and to ensure that appropriate analysis procedures are being performed on each domestic insurer.

g. Reporting of Material Adverse Findings

The Department's procedures should require that all material adverse indications be promptly presented to the commissioner or an appropriate designee for determination and implementation of appropriate regulatory action.

h. Action on Material Adverse Findings

Upon the reporting of any material adverse findings from the financial analysis staff, the Department should take timely action in response to such findings or adequately demonstrate the determination that no action was required.

2. Financial Examinations

a. Sufficient Qualified Staff and Resources

The Department should have the resources to effectively examine all domestic insurers on a periodic basis in a manner commensurate with the financial strength and position of each insurer.

b. Communication of Relevant Information to/from Examination Staff

The Department should provide relevant information and data received by the Department, which may assist in the examination process to the examination staff and ensure that findings of the examination staff are communicated to the appropriate person(s).

c. Use of Specialists

The Department's examination staff should include specialists with appropriate training and/or experience or otherwise have available qualified specialists, which will permit the Department to effectively examine any insurer. These specialists should be utilized where appropriate given the complexity of the examination or identified financial concerns.

d. Appropriate Supervisory Review

The Department's procedures for examinations should provide for supervisory review of examination workpapers and reports to ensure that the examination procedures and findings are appropriate and complete and that the examination was conducted in an efficient and timely manner.

e. Use of Appropriate Guidelines and Procedures

The Department's policies and procedures for the conduct of examinations should generally follow those set forth in the NAIC *Financial Condition Examiners Handbook*. Appropriate variations in methods and scope should be commensurate with the financial strength and position of the insurer.

f. Scheduling of Examinations

In scheduling financial examinations, the Department should follow procedures such as those set forth in the NAIC *Financial Condition Examiners Handbook* that provide for the periodic examination of all domestic companies on a timely basis. This system should accord priority to companies that exhibit adverse financial trends or otherwise demonstrate a need for examination.

g. Examination Reports

The Department's reports of examination should be prepared in accordance with the format adopted by the NAIC and should be sent to other states in which the insurer transacts business in a timely fashion.

h. Reporting of Material Adverse Findings

The Department's procedures should require that all material adverse findings be promptly presented to the commissioner or an appropriate designee for determination and implementation of appropriate regulatory action.

i. Action on Material Adverse Findings

Upon the reporting of any material adverse findings from the examination staff, the Department should take timely action in response to such findings or adequately demonstrate the determination that no action was required.

3. Information Sharing and Procedures for Troubled Companies

a. Information Sharing

States should allow for the sharing of otherwise confidential documents, materials, information, administrative or judicial orders, or other actions with the regulatory officials of any state, federal agency or foreign countries providing that the recipients are required, under their law, to maintain its confidentiality. States also should allow for the sharing of otherwise confidential documents, materials, information, administrative or judicial orders, or other actions with the NAIC providing that the NAIC demonstrates by written statement the intent to maintain its confidentiality. The Department should have a documented policy to cooperate and share information with respect to domestic companies with the regulatory officials of any state, federal agency or foreign countries and the NAIC directly and also indirectly through committees established by the NAIC,

which may be reviewing and coordinating regulatory oversight and activities. This policy should also include cooperation and sharing information with respect to domestic companies subject to delinquency proceedings.

b. Procedures for Troubled Companies

The Department should generally follow and observe procedures set forth in the NAIC *Troubled Insurance Company Handbook*. Appropriate variations in application of procedures and regulatory requirements should be commensurate with the identified financial concerns and operational problems of the insurer.

Part C: Organizational and Personnel Practices

1. Professional Development

The Department should have a policy that encourages the professional development of staff involved with financial surveillance and regulation through job-related college courses, professional programs, and/or other training programs.

2. Minimum Educational and Experience Requirements

The Department should establish minimum educational and experience requirements for all professional employees and contractual staff positions in the financial regulation and surveillance area, which are commensurate with the duties and responsibilities of the position.

3. Retention of Personnel

The Department should have the ability to attract and retain qualified personnel for those positions involved with financial surveillance and regulation.

Source: *Administrative Policies Manual of the Financial Regulation Standards and Accreditation Program*, January 1, 2009, pp. 9-16.