Exposure Drafts

The following guide may be used to assist in determining the location of the various revisions exposed during the May 18, 2015 conference call of the Financial Examiners Handbook (E) Technical Group.

1. Requirements for Related Part Transactions
   a. Section I, Part IV Narrative Guidance: pages 4 – 5
   b. Section II, Phase 1 Guidance: page 9

2. Redundancy Revisions
   a. Exhibit A: pages 10 – 12
   b. Exhibit B: page 16

3. References to Corporate Governance Annual Disclosure
   a. Section II, Phase 1 Guidance: page 22
   b. Exhibit B: pages 14 – 15, 17
   c. Exhibit M: page 27
IV. STANDARD EXAMINATION PROCEDURES

D. Review of Affiliated Transactions

This section provides guidance for identifying and examining affiliated transactions. There are two broad categories of affiliated 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 affiliated transaction occurs infrequently, but constitutes a difficult area.
- Transactions occurring in the ordinary course of business are considered affiliated transactions only because of an existing relationship between the transacting parties.

Generally, examiners are more concerned with detecting and disclosing the affiliated transactions in the first category than with the affiliated transactions that are transacted in the ordinary course of business. Even though the greatest exposure is focused on only a relatively few affiliated transactions, procedures are performed to encompass the broad definitions of affiliates and affiliated transactions. Additional considerations for affiliated transactions can be found in the Examination Repository – Related Party located in Section 3 of this Handbook.

An affiliated 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. Affiliated 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. 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.

Affiliated transactions also could include other transactions in which the reporting entity may not appear to be involved. Identifying these affiliated 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.

Transactions that, after study, cannot be understood as to their apparent motivation or appear to be commercially unreasonable raise the presumption that an affiliated transaction exists. Where subtle affiliated relationships are known or believed to exist, examiners should perform procedures to determine whether an affiliated 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 affiliated 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, affiliated 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.

**Affiliated Transactions with Partial or No Accounting Recognition**

Transactions by or among affiliates are considered to be affiliated transactions, 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 appear normal, might be involved in an affiliated transaction.

**Affiliates without Transactions**

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, an 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 is usually 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 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.

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.

Certain procedures that usually are performed to achieve other examination objectives also are used in identifying affiliates and affiliated transactions. These procedures include, but are not limited to:

(1) Considering guarantees indicated by confirmations of cash, investments, or loans receivable and payable.

(2) Examining invoices from law firms.

(3) Reviewing minutes.

(4) Reviewing year-end trial balance.

(5) Reviewing selected operations accounts.

(6) Reviewing shareholder listings of closely held companies to identify principal shareholders.

(7) Reviewing material investment transactions during the period under examination to determine whether they cause another entity to become a related party.

(8) Reviewing conflict-of-interest statements obtained by the entity from management and directors (covered in Exhibit B – Examination Planning Questionnaire). Conflict-of-interest statements provide the board of directors with information about the existence of relationships between persons completing the statement and parties with whom the entity transacts business.

Workpaper Documentation

Work performed related to affiliated 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. At a minimum, the examiner’s workpapers should include the following:

- A list of affiliates.
- A schedule or summary of identified affiliated transactions.
- An item in the company’s letter of representation regarding affiliates and affiliated transactions.
- An indication in the Examination Planning Memorandum as to whether any affiliated transactions were detected,
  and a description of any identified affiliated transactions that were not in the ordinary course of business or that
  otherwise required consideration of disclosure.
A. Part 1: Understanding the Company

Step 1: Gather Necessary Planning Information

Gathering information becomes the first step in this phase. Establishing an understanding of the insurer and its unique risks and the creation (or updating) of the Insurer Profile Summary (Exhibit H) is critical to a risk-focused examination process and facilitates continuing surveillance. Exhibit A – Examination Planning Procedures Checklist and Exhibit B – Examination Planning Questionnaire have been included in Section 4 of this Handbook to assist the examiner in gathering the necessary planning information.

During Step 1, the examiner should be identifying operating or financial reporting areas that will require focus during the examination. Sources of information supporting this understanding are:

- Documentation of ongoing monitoring completed by the Insurance Department Analyst;
- State Insurance Departments’ and other regulators’ reports;
- Public sources;
- 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);
- Company sources, including interviews with company management/board; and
- Interviews with the external auditor and reports issued, including a Management Letter if and/or when available.

The following are examples of the general types of information, including Information Technology related information that may be collected for review during the information gathering portion of the examination. The examiner is not required to obtain each of the following items and should use professional judgment in determining what information to gather to support a comprehensive understanding of the company and the risks faced. Additionally, the examiner should consult with the department analyst prior to requesting such information and leverage any relevant documents already obtained or review analysis that has been previously performed. An Examiner Request Log may be used to assist the examiner in requesting information from the company, when necessary.

Organization/Structure of Company

- Description of the organization structure, including legal and business units and any structural changes since the prior review;
- Business strategies, competitive challenges, key business lines, product mix, marketing emphasis, growth areas, acquisition or divestiture plans and new products or distribution channels introduced since the prior examination;
- Organizational charts, including detail on critical front, middle and back office units, existing automated information systems, and accounting and controllers functions;
- Description of the company’s relationship with affiliates and/or subsidiaries (see Section 1, Part IV, C – Review of Affiliated Transactions for additional guidance and requirements for documenting affiliates and affiliated transactions;
- Management contracts and incentive programs; and
- Significant Managing General Agent (MGA) and Third Party Administrator (TPA) contracts.

Corporate Governance Information

(Exhibit M – Understanding the Corporate Governance Structure has been provided to assist in understanding the corporate governance structure.)

- Board and audit committee minutes; and
- A list of critical management and operating committees and their members as well as meeting frequencies.
Sarbanes-Oxley Act of 2002

- Sarbanes-Oxley filings and initiatives;
- Sarbanes-Oxley documentation, including financial reporting risk and control documentation, Section 302 assertions and Section 404 attestations, whistleblower activity logs and conclusions, as applicable (to the extent that they are applicable to the company); and
- Supporting workpapers for the Sarbanes-Oxley filings including control narratives, flowcharts and testing documentation.

Annual Financial Reporting Model Regulation (Model Audit Rule #205)

- Documentation on auditor independence detailing partner rotation, prohibited services and cooling-off periods, as applicable;
- Documentation related to corporate governance, including the composition and independence of the audit committee; and
- Documentation of internal control over financial reporting, including Management's Report on Internal Control over Financial Reporting.

Risk-Management Information

- Descriptions of internal audit’s role in development of the entity’s risk management methodology and in risk monitoring and control;
- Recent external and internal auditor reports and management responses;
- Summary of the company’s overall risk profile, including significant areas of regulatory concern. *(Reviewing the Insurer Profile Summary may provide the examiner with this information.)*;
- Recent risk management reports detailing pricing/underwriting, market, credit, liquidity and reserving risk exposures and other key management reports;
- Assessments of the presence and effectiveness of internal control measures across primary business lines; and current year-to-date and prior-year comparisons of financial results to plan. *(This could include assessments made by the company—i.e., internal audit reports—or by the examiner as a result of prior-year examinations.)*; and
- Own Risk and Solvency Assessment (ORSA) summary report.

Internal Financial Statement and Solvency Information

- Shareholder/Annual reports;
- Company analyses of financial condition and trends;
- General ledger and supporting detail reconciled to the annual financial statement;
- Premium, claims and reserve data; and
- Material events affecting the insurer since the prior examination.

External Financial Statement and Solvency Information

- Rating agency reports and financial strengths;
- External auditor financial statement opinion report and management letters;
- External audit of internal control over financial reporting (Sarbanes-Oxley) report, as applicable to company;
- Actuarial opinion for years under review;
- Independent loss reserve report, if applicable;
- Financial press;
- SEC registration statements, most recent 10-K and 10-Q;
- Stock analyst reports; and
- External analyst reports including a brief summary of the insurer’s operations, as well as the degree to which internal controls are built into activities, the level and sophistication of automation, and whether new management information systems have been implemented since the prior on-site examination.

Regulatory Information

- The in-house financial analyst’s reports on the company’s financial condition and operating results since the last
examination; including the Insurer Profile Summary, assessed priority score, the overall financial analysis conclusion and Supervisory Plan;

- Current priority score and insurance departments issues;
- Summaries of regulatory activities since the prior examination, including market conduct and/or limited scope examinations;
- Financial statements for the years under review;
- Previous examination reports and supporting workpapers;
- Market conduct report;
- Management’s discussion and analysis report;
- Risk-based capital report;
- Holding company registration statements for years under review;
- Examination Jumpstart reports;
- IRIS reports;
- FAST scores reports;
- Department correspondence files;
- Inter-divisional memorandums;
- NAIC database reports (SAD, RIRS, CDS);
- Articles of Incorporation, bylaws and amendments;
- Recently approved agreements or contracts (e.g., expense-sharing agreements, reinsurance contracts, custodial agreements);
- Information from other insurance departments or other regulators; and
- Form F – Enterprise Risk Report.

**Information Technology (IT)**

Obtain and consider responses to Exhibit C: Part One – Information Technology Planning Questionnaire and supplemental exhibits related to:

- IT strategy, goals and objectives;
- IT organization structure and support structure;
- IT standards and procedures for:
  - System development
  - Program change control
  - Configuration management
  - Data center operations
  - Database administration
  - Performance monitoring
  - Capacity planning
  - Network administration
  - Information security
- System development methodology;
- Security incident reporting, monitoring and follow-up process;
- Physical security policy;
- Listing of any outside service provided/third party arrangements for processing;
- Summary of recent hardware/software/operations incident logs (e.g., mainframe, LAN WAN); and
- Vendor contracts/agreements including any addendums:
  - Disaster recovery plans
  - Disaster recovery testing results
  - Business resumption plans
  - Business resumption testing results

As part of reviewing the organizational structure of the company, the examiner 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 exam. 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 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 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?

Review prior examination report findings, management letter (if applicable) and working papers related to information systems reviews. Review the work performed by the company’s internal and external auditors relating to information systems reviews.

**Other Sources**
The AICPA publishes audit risk alerts as nonauthoritative 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.). For additional guidance regarding the consideration of related parties, refer to Section 1, Part IV D in this Handbook.
Phase 1 – Understand the Company and Identify Key Functional Activities to be Reviewed

Part 1: Understanding the Company

Step 1. Gather Necessary Planning Information

Obtain Existing Documentation

1. Complete, or have company personnel complete, as early as practical, Exhibit B – Examination Planning Questionnaire and the Information Technology Planning Questionnaire.

2. Obtain the most recent annual financial statement analysis completed by the in-house financial analyst to aid in the identification of significant risks and facilitate discussion with the analyst.

3. 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 readily 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, for years under review.
   b. Previous examination report and supporting workpapers.
   c. Market conduct report.
   d. CPA financial statement audit report.
   e. Actuarial opinion, for years under review.
   f. Independent loss reserve analysis report, if done.
   g. Management’s discussion and analysis letter.
   h. Risk-based capital report.
   i. Holding company registration statements, for years under review.
   j. SEC registration statements, most recent 10-K and 10-Q.
   k. CPA’s 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 (SAD, RIRS, CDS).
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.).
u. Own Risk and Solvency Assessment (ORSA) summary report.

Phase 1 – Understand the Company and Identify Key Functional Activities to be Reviewed

Part 1: Understanding the Company

Meet with the Company’s Appointed Actuary

14. 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.
Part 5: Consideration of Prospective Risks for 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. These risks may include:

   a. Consideration of the company’s asset/liability matching approach.

   b. Process for establishing loss reserves.

   c. Pricing and underwriting.

   d. Reinsurance arrangements.

   e. Consideration of the company’s rate of growth.

   f. Liquidity of assets concerns.
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. 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 impact the planned examination approach, and the nature, timing and extent of examination procedures performed.

Examiners may consider requesting the completion of Section K: Liquidity during intervals outside of the full-scope examination period (e.g., annually). The majority of 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.

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, using additional sheets 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.

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I. OWNERSHIP AND MANAGEMENT INFLUENCES

A. Concentration of Ownership

1. Provide documentation explaining:

   a. The concentration of ownership.

   b. The approximate number of shareholders.

   c. Any significant shareholders.

   d. Changes in ownership.

   e. Whether shares are actively traded.

   f. The extent of management’s ownership interest.
## B. The Board of Directors and its Committees

The purpose of this section is to gather information related to the insurer’s Board of Directors and its committees, including the Audit Committee. 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 filed with the insurance department. If the Corporate Governance Annual Disclosure is available to the examiner, this section may be removed from the questionnaire prior to providing to the company for completion.

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.

## C. Audit Committee

21. Provide information on the audit committee. This information should include:

   a. The number of members that serve on the committee.

   b. The names of the members of the audit committee that 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 that 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.

## D. Duties of the Board and Its Committees

Comment [HB1]: These revisions relate to the Corporate Governance Annual Disclosure
34. 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.

42. 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.

53. Describe the following board activities and provide 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?

64. 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?

**CE. 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?

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 impacted 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?

DE. 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.).

EG. 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. ORGANIZATION AND PERSONNEL PRACTICES

A. Organization

1. Provide details of the company structure, including:

   a. Corporate structure chart (by legal/business unit).

   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 reporting and communication.

d. A list of critical management and operating committees and their members.

2. Provide formal position descriptions for administrative and financial personnel.

3. 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?

4. Does the company have a written corporate governance framework? If so, describe how the corporate governance framework is:
   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.
   c. Built by reliable business planning and proactive resource allocation.
   f. Reinforced by firm adherence to sound principles of segregation of duties.
   g. Independent in the 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.

Comment [HB3]: These revisions relate to the Corporate Governance Annual Disclosure.
### B. Personnel

1. Describe the investigation of backgrounds and references during the recruitment and selection process for new employees 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. List any officers that have been associated with a company that has become insolvent or placed in receivership, suffered a revocation of license or ordered to cease and desist from violations of insurance law or regulations.
   a. If applicable, have the officers describe their roles in the insolvency, receivership, etc.

5. How are personnel policies, including hiring, evaluation and termination, documented and communicated to employees?

6. Are employees who handle cash, securities, and other valuable assets bonded? List those covered, the amount of coverage and deductible.

7. Are any related persons employed within the company? If yes, provide their names, job titles and relationship.

8. To what extent is rotation of duties enforced by mandatory vacations? Explain.

9. To what extent is job performance periodically evaluated and reviewed with each employee?

10. To what extent are there formal training programs for administrative and financial personnel? Provide documentation describing the training provided.

11. Describe the organization structure of your compliance and ethics management team.

12. 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.

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 CIAs.
   d. Scope restrictions. If any, consider internal audit’s 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?

8. 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.

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?

6. Do budgets and forecasts cover:
   a. Premium income by line of insurance?
   b. Policy benefits by line of insurance?
   c. General expenses?
   d. Investments (allocation of investable funds, and income and expenses)?
   e. Statutory surplus?
   f. Federal income taxes?
   g. Cash flow?

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?

3. Describe the review and approval process, including who reviews and approves financial information for public distribution (e.g., press releases, filings with regulatory bodies and policyholders' or shareholders' reports).

4. To what extent does management assess the effectiveness of the company’s internal control over financial reporting?
   a. Did management assess the internal controls over financial reporting as effective? Please provide management’s assessment.
   b. Did the company’s external auditor issue an unqualified opinion as to management’s assessment? Please provide the auditor’s opinion.

---Detail Eliminated to Conserve Space---
PHASE 1 – UNDERSTAND THE COMPANY AND IDENTIFY KEY FUNCTIONAL ACTIVITIES TO BE REVIEWED

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 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.

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 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.

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 an 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 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 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 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 controllership officers 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 X of this Handbook in conjunction with the review of the ORSA summary report.
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 an 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 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.

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 members.

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?