FINANCIAL EXAMINERS HANDBOOK (E) TECHNICAL GROUP
Conference Call
Wednesday, September 27, 2017
2:00 p.m. ET/ 1:00 p.m. CT

ROLL CALL

<table>
<thead>
<tr>
<th>Name</th>
<th>State/Region</th>
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<tbody>
<tr>
<td>Susan Bernard, Chair</td>
<td>California</td>
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<tr>
<td>Omar Akel/Renee Hanshaw</td>
<td>Nevada</td>
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<td>Richard Ford</td>
<td>Alabama</td>
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<td>Colin Wilkins</td>
<td>New Hampshire</td>
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<td>William Arfanis</td>
<td>Connecticut</td>
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<td>Steve Kerner</td>
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<td>N. Kevin Brown</td>
<td>District of Columbia</td>
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<td>Tracy Snow</td>
<td>Ohio</td>
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<td>Cindy Andersen</td>
<td>Illinois</td>
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<td>Joel Sander</td>
<td>Oklahoma</td>
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<td>Grace Kelly</td>
<td>Minnesota</td>
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<td>Missy Greiner</td>
<td>Pennsylvania</td>
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<td>Leslie Nehring/Levi Nwasoria</td>
<td>Missouri</td>
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<td>Patrick McNaughton</td>
<td>Washington</td>
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<td>Justin Schrader</td>
<td>Nebraska</td>
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<td>John Litweiler</td>
<td>Wisconsin</td>
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<td>NAIC Support Staff: Bailey Henning</td>
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AGENDA

1. Receive Comments on Exposure Draft and Consider Adoption—Susan Bernard (CA)
   - Exposure Drafts
     - Guidance Related to Communication Between Analyst and Examiner
     - Handbook Technical Group Amendment Procedures
     - Guidance Related to Examination Repository Updates
     - Guidance Related to Referral from PBR Review (E) Working Group
     - Guidance Related to Referral from Receivership Model Law (E) Working Group
   
   - Comment Letters
     - American Academy of Actuaries
     - Fontaine Consulting, LLC
     - Joint Interested Parties

   - Financial Analysis (E) Working Group Referral
   - Section 1-3: Run-off Examinations
   - Section 2-1: Redomestication

3. Consider Exposure of Handbook Guidance Related to Clean-Up—Susan Bernard (CA)
   - Section 1-1: Review & Reliance on Another State’s Workpapers (Coordination Plan)
   - Exhibit E

4. Review 2017 Project Listing—Susan Bernard (CA)

5. Any Other Matters Brought Before the Technical Group—Susan Bernard (CA)

6. Adjournment
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Attachment One

Exposure Drafts:

• Communication Between Examiner and Analyst
• Handbook Technical Group Amendment Procedures
• Examination Repository Updates
• Revisions related to referral from PBR Review (E) Working Group
• Revisions related to referral from Receivership & Insolvency (E) Task Force
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To: Commissioner Todd E. Kiser, Chair, Financial Regulation Standards and Accreditation (F) Committee  
From: Judy Weaver, Chair, Financial Analysis Handbook (E) Working Group  
Date: July 10, 2017  
Re: Revisions to Accreditation Review Team Guidelines for Risk-Focused Analysis


Within the revisions is included a change to the process-oriented guidelines for communication of relevant information to/from financial analysis staff (b.3.). The Financial Examiners Handbook (E) Technical Group reviewed the revisions on their June 29 conference call and drafted coordinating revisions to examination guidelines necessary for consistency, which will be referred separately.

Please contact Financial Analysis Handbook (E) Working Group staff Jane Koenigsman (jkoenigsman@naic.org) if you have any questions or would like additional information.
b. Communication of Relevant Information to/from Financial Analysis Staff

**Standard:** The department should ensure that all relevant information and data obtained that may assist in the financial analysis process is provided to the financial analysis staff. The department should ensure that findings of the financial analysis staff are communicated to the appropriate person(s) within the department.

**Results-Oriented Guidelines:**

1. Analysts should effectively communicate and coordinate with various areas within the department, including management, the financial examination staff and other non-financial areas, as applicable. Evidence of this communication should be clearly documented in the analysis files. When assessing compliance with this guideline, consideration should be given to the following:
   - The analyst’s utilization of pertinent information that is obtained from management and/or other areas of the department
   - Sharing by the analyst of any pertinent information obtained as a result of the financial analysis with management and/or other areas of the department
   - The analyst’s communication and collaboration with the financial examination staff before, during and at the conclusion of a financial examination
   - The analyst’s utilization and incorporation of pertinent information from the financial examination in conducting ongoing analysis procedures.

**Process-Oriented Guidelines:**

1. The analysis process should include a formal periodic method that allows for pertinent information from other areas (e.g. legal, rates and forms, actuarial, etc.) that could impact the financial analysis process to be shared with the financial analysis staff. Although no one method is required, the following are examples that may demonstrate compliance: quarterly department heads meetings, department managers’ meetings, information requests to other areas, etc.

2. Financial solvency information identified as a result of the financial analysis, particularly adverse findings or significant unresolved issues, should be communicated to management and other department staff, as necessary.

3. Results of ongoing analysis procedures should be shared with the financial examiners to assist in examination planning. At the beginning of each examination, the analyst should communicate areas of concern and specific issues to address during the examination. To assist in communication, the analyst should provide a current copy of the Insurer Profile Summary as well as any other supporting documentation necessary to communicate concerns and suggested procedures.

1. Results of ongoing analysis procedures should be shared with the financial examiners to assist in examination planning through a coordination meeting. An email exchange alone, between analyst and examiner is not considered sufficient communication in planning an examination. During the planning process of each examination, the analyst should meet (in person or via conference call) with the examiner to communicate areas of concern and specific issues to address during the examination. To assist in communication, the analyst should provide a current copy of the Insurer Profile Summary as well as any other supporting documentation necessary to communicate concerns and suggested procedures.
Profile Summary as well as other supporting analyst work papers and other documentation already on file at the department to communicate current or prospective concerns or observations and suggested procedures.

1.2. The financial analyst should participate in a collaborative follow-up meeting or conference call at the end of the examination to discuss the following:

- Examination results and/or findings
- Insurer’s prioritization level
- Ongoing supervisory plan and the completed Summary Review Memorandum
- Re-assessment of branded risks as contained in the Insurer Profile Summary

5. The analyst should follow-up with the insurer to address concerns/issues identified as a result of examination activities, which may include examination report findings, management letter comments or prospective risks.

--------------------------------------------DETAIL ELIMINATED TO CONSERVE SPACE----------------------------
b. Communication of Relevant Information to/from Examination Staff

Standard: The department should ensure that all relevant information and data obtained that may assist in the financial examination process is provided to the financial examination staff. The department should ensure that findings of the financial examination staff are communicated to the appropriate person(s).

Results-Oriented Guidelines:

1. Examiners should effectively communicate and coordinate with various areas within the department. Such communication should consist of both: 1) communication of information held by other areas of the department to the examiners as appropriate to enhance the quality of the examination; and 2) communication of key examination findings to other areas of the department as appropriate to enhance the work performed by those other areas. Evidence of this communication should be clearly documented in the examination files. When assessing compliance with this guideline, consideration should be given to the following:
   - The examiner’s utilization of pertinent information that is obtained from management and/or other areas of the department.
   - Sharing by the examiner of any pertinent information obtained as a result of the financial examination with management and/or other areas of the department.
   - The examiner’s communication and collaboration with the financial analysis staff before, during and at the conclusion of a financial examination.
   - The examiner’s utilization and incorporation of pertinent information from the financial analysis in planning and conducting examination procedures.

Process-Oriented Guidelines:

1. The examination process should include a formal method that allows for pertinent information from other areas (e.g., legal, rates and forms, actuarial, etc.) within the department that could impact the financial examination to be shared with the examination staff. Although no one method is required, the following are examples that may demonstrate compliance: regularly scheduled department head meetings, department managers’ meetings, information requests to other areas of the department, etc.).

2. The examiner-in-charge (EIC) should provide a status report to the chief examiner (or designee) at least monthly and include information as required by the NAIC Financial Condition Examiners Handbook (Examiners Handbook).

3. Financial solvency information identified as a result of the financial examination, particularly adverse findings or significant unresolved issues, should be communicated by the examination team to the chief examiner, financial analyst, management and other department staff, as necessary.

4. At the beginning of each examination, the examiner should meet (in person or via conference call) with the assigned financial analyst (and/or analyst supervisor) to obtain input from the financial analyst regarding areas of concern and specific issues to address during the examination. An email exchange alone is not considered sufficient communication in
planning an examination. To assist in gathering this information, the examiner should obtain a current IPS from the financial analyst, as well as any other supporting analyst workpapers and other documentation already on file at the department to communicate current or prospective necessary to understand the financial analyst’s concerns or observations and suggested procedures.

5. Results of examination activities should be shared with the financial analyst to assist in conducting ongoing analysis procedures. At the conclusion of an examination, the examiner should hold a collaborative follow-up meeting or conference call with the financial analyst to discuss the following:
   - Examination results and/or findings.
   - Insurer’s prioritization level.
   - Ongoing supervisory plan and the completed SRM.
   - Assessment of branded risks contained in the IPS.

6. The examiner should recommend follow-up for the financial analyst to perform in addressing concerns/issues identified as a result of examination activities. In so doing, the examiner should communicate examination report recommendations, management letter comments and/or prospective risks. Information to be provided as a result of each full-scope examination should include the report of examination, management letter (if used) and SRM (or substantially similar document).
COMPANY NAME __________________________________________________________________________

PERIOD OF EXAMINATION _________________________________________________________________

The following checklist details the components of Phase 1 and Phase 2, as well as other information that should be considered during the planning process. Narrative guidance is provided within Section 2 of this Handbook to aid examiners in understanding the risk-focused surveillance process.

**Pre-planning Procedures**

1. At least six months prior to the as-of date, notify the company and its external auditors, with company personnel’s assistance, that an examination will take place and that the auditor workpapers will be requested when the exam begins.

2. If the examination is to be performed on a company that is part of a holding company group, send an informal notification at least six months prior to the as-of date to other states that have domestics in the group.

3. Call the examination in the Financial Exam Electronic Tracking System (FEETS) at least 90 days prior to the exam start date.
   - a. If the examination is to be performed on a company that is part of a holding company group, document your attempts to coordinate the exam with the Lead State and other domestic state(s) within your group. Utilize Exhibit Z – Examination Coordination to assist with this process.

4. Send preliminary information requests to the company with sufficient lead-time to allow information to be provided prior to the start of examination fieldwork. Exhibit B – Examination Planning Questionnaire and Exhibit C, Part One – Information Technology Planning Questionnaire can be utilized to assist in developing pre-planning requests. **Note**: The examiner is encouraged, with input from the financial analyst when possible, to customize Exhibit B to the insurer being examined prior to submitting the information request.

<table>
<thead>
<tr>
<th>Examiner</th>
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**Phase 1 – Understand the Company and Identify Key Functional Activities to be Reviewed**

**Part 1: Understanding the Company**

Step 1. Gather Necessary Planning Information

*Meet with the Financial Analyst*

1. Meet *(in person or via conference call)* with the assigned financial analyst (and/or analyst supervisor) to gain an understanding of
company information available to the department. In addition, discuss risks and concerns highlighted in the Insurer Profile Summary as well as the company’s financial condition and operating results since the last examination. Ascertain the reasons for unusual trends, abnormal ratios and transactions that are not easily discernible. Document a summary of significant risks identified by the analyst for further review on the examination.

**Note:** An email exchange, in and of itself, is not deemed sufficient to achieve the expectation of a planning meeting with the assigned analyst.

a. If deemed necessary, obtain supporting documentation from the most recent annual financial statement analysis to aid in the identification of significant risks and facilitate ongoing discussion with the analyst.
The Examination Planning Questionnaire contains procedures and questions that are designed to assist the examiner in gathering necessary planning information and obtaining an understanding of the insurer’s organization. The examiner or company personnel should complete this questionnaire as early in exam planning as practical. If company personnel complete this exhibit, identification of who completed each request, as well as supporting documentation, should be provided to the examination team and the responses to this questionnaire should be critically evaluated by the examiner. If information requested through the questionnaire has already been provided to the department, the company’s response should so state and reference when and how the information was provided. The substance of the information collected during the completion of this questionnaire should be incorporated into the Examination Planning Memorandum. The questionnaire responses should be considered when identifying the inherent risks of the insurer. They should also 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.

**Customization of Questionnaire Prior to Distribution**

This questionnaire should be customized to the insurer being examined to allow the examiner or company personnel completing the questionnaire to focus only on the applicable questions. The questions that remain should be completely addressed, providing additional support if necessary. It is possible that the financial analyst has performed work in these areas as part of the analysis procedures; therefore, prior to completion of the questionnaire, the exam team should communicate with the analyst to determine whether the information has already been obtained in order to reduce duplication of work and duplicative information requests to the insurer.

To assist the exam team in identifying information that may already be provided to the department, requests that may be collected through the financial analysis process have been denoted with an asterisk (*) for ease in identification and potential removal from the questionnaire.

**Instructions for Completing Exhibit**

Please provide the most current version of the following items to the examination team within the specified timeline. If a requested item has already been provided to the department, please note the date and to whom it was provided.

<table>
<thead>
<tr>
<th>COMPLETED BY</th>
<th>SUPPORTING DOCUMENTATION</th>
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<tbody>
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I. OWNERSHIP AND MANAGEMENT INFLUENCES

A. Concentration of Ownership

1. Provide documentation explaining:

   a. The concentration of ownership.*
The following establishes procedures of the Financial Examiners Handbook (E) Technical Group (Technical Group) for proposed changes, amendments and/or modifications to the Financial Condition Examiners Handbook.

1. The Technical Group may consider relevant proposals to change the NAIC Financial Condition Examiners Handbook (Handbook) at any conference call, interim or national meeting (“the meeting”) throughout the year as scheduled by the Technical Group.

2. If a proposal for suggested changes, amendments and/or modifications is submitted to, or filed with, NAIC staff support it may be considered at the next regularly scheduled meeting of the Technical Group.

3. The Technical Group publishes a formal submission form and instructions that can be used to submit proposals and is available on the Group’s webpage. However, proposals may also be submitted in an alternate format provided that they are stated in a concise and complete format. In addition, if another NAIC committee, task force or Technical group is known to have considered this proposal, that committee, task force or Technical group should provide any relevant information.

4. Any proposal that would change the Handbook will be effective following the NAIC Fall/Winter National Meeting (i.e. of the preceding year) in which it was adopted (e.g., a change proposed to be effective January 1, 2018 must be adopted no later than the 2017 Fall/Winter National Meeting).

5. Upon receipt of a proposal, the Technical Group will review the proposal at the next scheduled meeting and determine whether to consider the proposal for public comment. The public comment period shall be thirty days unless extended by the Technical Group. The Technical Group will consider comments received on each proposal at its next meeting and take action. Proposals under consideration may be deferred by the Technical Group until the following scheduled meeting. The Technical Group may form an ad hoc group to study the proposal, if needed. The Technical Group may also refer proposals to other NAIC committees for technical expertise or review. If a proposal has been referred to another NAIC committee, the proposal will come off the Technical Group’s agenda until a response has been received.

6. NAIC staff support will prepare an agenda inclusive of all proposed changes. The agenda and relevant materials shall be sent via e-mail to each member of the Technical Group, interested regulators and interested parties and posted to the Technical Group’s webpage approximately 5-10 business days prior to the next regularly scheduled meeting during which the proposal would be considered.

7. In rare instances, or where emergency action may be required, suggested changes and amendments can be considered as an exception to the above stated process and timeline based on a two-thirds majority consent of the Technical Group members present.

8. NAIC staff support will publish the Handbook on or about February 28, each year. NAIC staff will post to the NAIC Publications Web site any material subsequent corrections to these publications.
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Annual Statement Blank Line Items

Listed below are the corresponding Annual Statement line items that are related to the identified risks contained in this exam repository:

Amounts Recoverable from Reinsurers
Funds Held by or Deposited with Reinsured Companies
Other Amounts Receivable Under Reinsurance Contracts
Ceded Reinsurance Premiums Payable (Net of Ceding Commissions)
Funds Held by Company Under Reinsurance Treaties (P&C Companies)
Funds Held Under Reinsurance Treaties with Unauthorized Reinsurers (Life Companies)
Provision for Reinsurance
Contract Liabilities Not Included Elsewhere – Other Amounts Payable on Reinsurance
Miscellaneous Liabilities – Reinsurance in Unauthorized Companies (Life Companies)
Funds Held Under Coinsurance (Life Companies)

Relevant Statements of Statutory Accounting Principles (SSAPs)

All of the relevant SSAPs related to the reinsurance process, regardless of whether or not the corresponding risks are included within this exam repository, are listed below:

No. 5R Liabilities, Contingencies and Impairments of Assets – Revised
No. 25 Affiliates and Other Related Parties
No. 61R Life, Deposit-Type and Accident and Health Reinsurance – Revised (Health/Life Companies)
No. 62R Property and Casualty Reinsurance – Revised (P&C Companies)
No. 63 Underwriting Pools (Health/Life Companies)
No. 64 Offsetting and Netting of Assets and Liabilities
No. 65 Property and Casualty Contracts (P&C Companies)
<table>
<thead>
<tr>
<th>Identified Risk</th>
<th>Branded Risk</th>
<th>Exam Asrt.</th>
<th>Critical Risk</th>
<th>Possible Controls</th>
<th>Possible Test of Controls</th>
<th>Possible Detail Tests</th>
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<tr>
<td>Other Than Financial Reporting Risks</td>
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<td>The insurer does not accurately identify, accumulate and track its aggregate loss exposures that may require reinsurance coverage.</td>
<td>ST</td>
<td>Other</td>
<td>AARP</td>
<td>The insurer has a risk management function in place to identify, track and monitor various loss exposures (e.g., catastrophic risk, mortality, morbidity, epidemic, etc.). The insurer has processes in place to ensure that policy information is correctly captured in the system (See also Examination Repository – Underwriting). (Note: This function may be outsourced to a TPA/MGA). The (re)insurer has a process in place to review and accumulate loss exposure data reported by its ceding insurer/brokers for inclusion in tracking aggregate loss exposure (See also Examination Repository – Reinsurance Assumed). If this process is outsourced to a third-party administrator (TPA) or managing general agent (MGA), the insurer has a process in place to ensure that the TPA/MGA correctly inputs data into the system.</td>
<td>Review and test the operating effectiveness of the insurer’s processes to identify, track and monitor relevant loss exposures. Test controls relating to the accuracy of policy data uploaded (by the insurer or a TPA/MGA) to the system (See also Examination Repository – Underwriting). Review and test the operating effectiveness of the (re)insurer’s processes to review and accumulate loss exposure data reported by ceding insurers/brokers (See also Examination Repository – Reinsurance Assumed).</td>
<td>Select a sample of directly underwritten policies to verify that the insurer has correctly recorded loss exposure data associated with relevant policies (See also Examination Repository – Underwriting). Analytically review the loss exposure data reported to the company by ceding insurers/brokers on assumed business to identify potential inconsistencies (See also Examination Repository – Reinsurance Assumed). If deemed necessary, perform additional procedures to get comfort with the loss exposure data reported to the (re)insurer from ceding insurers/brokers on assumed business (See also Examination Repository – Reinsurance Assumed).</td>
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<tr>
<td>The insurer has not established and</td>
<td>ST</td>
<td>Other</td>
<td>AARP</td>
<td>The insurer has a well-defined reinsurance strategy</td>
<td>Review meeting minutes of the board of directors (or a</td>
<td>Review the insurer’s reinsurance levels for</td>
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<td>Identified Risk</td>
<td>Branded Risk</td>
<td>Exam Asrt.</td>
<td>Critical Risk</td>
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<td>maintained appropriate reinsurance levels in accordance with the company’s capital level, loss exposures and underwriting risk profile.</td>
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<td>that is based on the aggregate loss exposures it faces. The strategy indicates the type of reinsurance (e.g., aggregate excess of loss, per occurrence, etc.) to be maintained by the organization and is approved by the board of directors (or a committee thereof).</td>
<td>committee thereof) or other evidence of board involvement in the approval of the insurer’s reinsurance policy.</td>
<td>appropriateness. Consider the results of data aggregation/models to assist in this assessment.</td>
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<tr>
<td>The insurer has established and documented exposure limits and a risk appetite that have been reviewed and approved by senior management.</td>
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<td>Review aggregated/modeled loss exposure data is utilized by the company to reach reinsurance decisions.</td>
<td>Review documentation of reinsurance coverage limits and evidence of senior management review/approval.</td>
<td>Review the insurer’s reinsurance coverage as compared to the risk being retained by the insurer to ensure adequate, but not excessive, reinsurance levels.</td>
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<td>The insurer reinsures all exposures that exceed the exposure limits and maintains coverage in accordance with its risk appetite.</td>
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<td>Review a summary of all reinsurance contracts to ensure that the coverages match the insurer’s exposure limits.</td>
<td>Review evidence of interaction between the underwriting, claims and reinsurance areas.</td>
<td>Calculate the historical aggregate profitability of reinsurance.</td>
</tr>
<tr>
<td>The insurer has developed formal documentation of its reinsurance structure and has established an effective, ongoing dialogue among the underwriting, claims and reinsurance areas.</td>
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<td>Review the insurer’s analysis of results gross and net of reinsurance.</td>
<td>Consider applying a range of scenarios to a selection of significant reinsurance contracts to test the overall performance/prospective profitability of the contract and to assess whether the ceding commission is greater than the cost to write the business.</td>
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<td>The insurer has a process in place to evaluate the effectiveness of its reinsurance coverage.</td>
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<th>Possible Controls</th>
<th>Possible Test of Controls</th>
<th>Possible Detail Tests</th>
</tr>
</thead>
<tbody>
<tr>
<td>The insurer’s catastrophic reinsurance protections are inadequate.</td>
<td>ST</td>
<td>Other</td>
<td>AARP</td>
<td>The insurer performs a cost/benefit analysis prior to entering into reinsurance agreements.</td>
<td>Review the insurer’s cost/benefit analysis.</td>
<td>Review the reasonableness of the catastrophic reinsurance coverage in place at the insurer by benchmarking against competitors and/or comparing against industry standards. Consider involving an exam actuary or reinsurance specialist in assessing the adequacy of the insurer’s catastrophic reinsurance coverage.</td>
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<td>OP</td>
<td>Other</td>
<td>AARP</td>
<td>The insurer uses one of the industry’s catastrophic modeling software tools (RMS, AIR, EQECAT, etc.) to determine the probable maximum loss (PML) by zone.</td>
<td>Review the adequacy of the process and tools utilized to determine the insurer’s PML amount(s).</td>
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<td></td>
<td>ST</td>
<td>Other</td>
<td>AARP</td>
<td>The process includes actuarial involvement with the ceded reinsurance department to insure the ceded department purchases the proper amount of reinsurance.</td>
<td>Determine whether the insured’s reinsurance strategy includes the involvement of the actuarial and ceded reinsurance departments in the purchasing of catastrophic reinsurance.</td>
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<td></td>
<td>ST</td>
<td>Other</td>
<td>AARP</td>
<td>The insurer adjusts its retentions or uses reinsurance alternatives, such as cat bonds, to ensure full placement at each catastrophic layer.</td>
<td>Review the coverages in place for each layer of reinsurance for appropriate supervisory review.</td>
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<td></td>
<td>ST</td>
<td>Other</td>
<td>AARP</td>
<td>The insurer has protected itself against multiple occurrences in the same period with contractual reinstatement of coverage.</td>
<td>Determine whether the insurer’s reinsurance strategy requires premium reinstatement for the cat program.</td>
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<tr>
<td>The insurer is over-exposed to credit and liquidity risks in its use of reinsurance counterparties.</td>
<td>OP</td>
<td>Other</td>
<td>AARP</td>
<td>The insurer has policies in place requiring utilization of multiple reinsurers to reduce concentration with any one entity.</td>
<td>Test the operating effectiveness of the insurer’s controls to track compliance with the concentration policy.</td>
<td>Based on a review of significant contracts, determine whether the insurer is properly diversified.</td>
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<td>Identified Risk</td>
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<td>The insurer has developed a formal process to approve reinsurance counterparties.</td>
<td>Obtain evidence of the company’s process to approve reinsurance counterparties.</td>
<td>Perform procedures to evaluate the quality of significant reinsurers utilized by the insurer, for example:</td>
<td>• Review agency ratings&lt;br&gt;• Review financial results&lt;br&gt;Contact domestic regulator regarding any concerns</td>
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<td>The insurer has a process in place to preapprove and set maximum limits to be ceded to reinsurers that are monitored and revised, as necessary.</td>
<td>Obtain evidence of the preapproval process and documentation of maximum reinsurance limits.</td>
<td>For select reinsurers, verify that the balance currently ceded is within the maximum limits set by the insurer.</td>
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<tr>
<td>The insurer continually monitors the financial solvency of its reinsurers throughout the duration of the reinsurance contracts.</td>
<td>Obtain evidence of the insurer’s ongoing review of its reinsurers.</td>
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<tr>
<td>Collateral is held in association with significant treaties to encourage prompt settlement and fulfillment of obligations.</td>
<td>Obtain evidence of the insurer’s process to consider/require collateral to be held for significant treaties.</td>
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<tr>
<td>Reinsurance counterparties are not likely to fulfill their obligations.</td>
<td>The insurer has developed a formal process to approve reinsurance counterparties.</td>
<td>Perform procedures to evaluate the quality of significant reinsurers utilized by the insurer, for example:</td>
<td>• Review agency ratings&lt;br&gt;• Review financial results&lt;br&gt;Contact domestic regulator regarding any concerns</td>
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<tr>
<td>CR LQ</td>
<td>AARP RRC</td>
<td>Other</td>
<td></td>
<td>New counterparties are subject to review and approval in accordance with standards.</td>
<td>Select a sample of new counterparties to determine whether controls are operating effectively.</td>
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<tr>
<td>Identified Risk</td>
<td>Branded Risk</td>
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<td>Smaller, less complex or new insurers are unable to negotiate equitable reinsurance contract terms from larger or more experienced reinsurers.</td>
<td>OP ST LQ</td>
<td>Other</td>
<td>AARP</td>
<td><strong>Collateral is held in association with significant treaties to encourage prompt settlement and fulfillment of obligations.</strong></td>
<td>Obtain evidence of the insurer’s process to consider/require collateral to be held for significant treaties.</td>
<td>Review the credentials, background and experience of those negotiating the contracts to ensure that they are licensed to represent the insurer in contract negotiations.</td>
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</tbody>
</table>

**Financial Reporting Risks**

| Reinsurance contracts with affiliates have not been filed in accordance with applicable state statutes and do not include equitable contract provisions. | OP ST       | CM AC     | AARP RPHCC | The insurer has policies and procedures in place to ensure all contracts with affiliates are filed with the insurance department as required by applicable state statutes (Form D filing). The insurer has policies in place to ensure that all contracts with affiliates are negotiated at arm’s length and are in accordance with statutory accounting principles (SAP). These policies ensure that:  
- Contracts are subject to review and approval by senior management;  
- Ceding commissions are sufficient to cover the insurer’s underwriting expenses.  
- Contract terms comply with SSAP No.25; | Review the insurer’s policies and procedures in place to ensure such policies adhere to applicable statutes and would adequately identify transactions requiring a filing.  
Test the insurer’s process to ensure that transactions with related parties are negotiated at arm’s length by obtaining evidence of senior management review and approval and support for the sufficiency of ceding commissions, risk transfer and adequate pricing. | Obtain and review the significant contracts between the insurer and its affiliates and ensure that agreements are filed with the insurance department in accordance with applicable state requirements. Verify that the insurer is operating in accordance with approved contract terms.  
Review contract provisions for reasonableness through conducting analytical procedures such as comparing ceding commissions to the insurer’s expense ratio or comparing actual to expected results.  
Consider involving a reinsurance expert or actuarial examiner to review complex contracts and/or |
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<tbody>
<tr>
<td>Reinsurance contracts are not completed and accounted for in compliance with SAP and applicable state requirements.</td>
<td>OP</td>
<td>PD EX OB/OW VA</td>
<td>RRC</td>
<td>• Reinsurance is not being used to transfer capital to affiliates; and • Actuarial review is performed prior to contract execution to ensure that policies are enforced.</td>
<td>Evaluate procedures in place to ensure multiple cedent contracts have fair and equitable allocation terms and are subject to review and approval by all impacted divisions (e.g., accounting, actuarial, etc.).</td>
<td>those with questionable provisions. Consider performing independent testing to evaluate the reasonableness of contract pricing and terms. Review significant multiple cedent agreements to ensure allocation terms and agreements are clearly documented and equitable.</td>
</tr>
<tr>
<td>The insurer has policies in place to ensure multiple cedent contracts have fair and equitable allocation terms and are subject to review and approval by all impacted divisions (e.g., accounting, actuarial, etc.).</td>
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<tr>
<td>The insurer evaluates all reinsurance contracts to ensure that there is adequate transfer of risk, in compliance with SAP.</td>
<td>The insurer evaluates all reinsurance contracts to ensure that there is adequate transfer of risk, in compliance with SAP.</td>
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<td></td>
<td>Examine contracts for evidence of insurer evaluation and review for all required regulatory elements. • For P&amp;C insurers, review the insurer’s policies and procedures in place to 1) determine how the reinsurance agreement is accounted for (prospective, retroactively or deposited in accordance with SSAP No. 62R); and 2) ensure the agreement includes required agreement terms. • For life insurers, review the insurer's policies and procedures in place</td>
<td>Obtain copies of all significant reinsurance contracts in-force and complete Exhibit N, Part Three, to ensure transfer of risk. If a contract does not transfer risk, verify whether it has received deposit accounting treatment in accordance with SAP. Obtain copies of all significant reinsurance contracts in-force for the period under examination. Determine whether the contract includes effective date and execution date, payment terms, termination clause, insolvency clause,</td>
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| The insurer is not accurately billing and recording loss and loss adjustment expense (LAE) payments for policies linked to reinsurance contracts. | OP LQ | EX CO AC | RRC | finalized, reduced to written form and signed in accordance with applicable SSAPs.  
- For P&C insurers, contracts must be executed within nine months of effective date or accounted for as retroactive agreements in accordance with SSAP No. 62R.  
- For life insurers, credit for reinsurance is not authorized if the agreement, amendment or binding letter of intent is not executed by both parties by the “as-of” date of the financial statement in accordance with Appendix A-791. | to ensure compliance with Appendix A-791. | policies/lines of business reinsured, insurer retention, etc.  
For a sample of P&C reinsurance contracts, determine whether the effective date and the execution date fall within nine months of each other or that the contract is accounted for retroactively in accordance with SSAP No. 62R.*  
For a sample of life reinsurance contracts, determine whether the effective date and execution date meet Appendix A-791 requirements.* | Perform procedures related to the NAIC Examination Jumpstart approach to test whether the level of ceded recoverables are reasonably equivalent to the level of assumed liabilities reported by the assuming reinsurers.  
For a sample of reinsurance recoverable balances, agree the balance to a valid reinsurance contract, noting whether reinsurance premiums have been paid; the claims are covered under the reinsurance contract. |
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<td>with all of the relevant claim information required by the reinsurer and a corresponding recoverable amount is recorded.</td>
<td>The insurer has procedures in place whereby timely notice is provided to the reinsurer in accordance with reporting requirements (e.g., reported claims in excess of 50% of retention, death or dismemberment).</td>
<td>Records associated with reinsurance recoverable balances are appropriately restricted, conform to standards outlined in the reinsurance treaty and provide adequate supporting evidence for the net recoverable balances.</td>
<td>Test the operating effectiveness of controls over the reinsurance recordkeeping process by observing access restrictions and inspecting documents demonstrating supervisory review of reinsurance recordkeeping.</td>
<td>Review audit reports and other documentation to determine whether the insurer provides sufficient oversight of its TPAs/MGAs.</td>
<td>In conjunction with testing performed in the Examination Repository – Reserves/Claims Handling test a sample claims (including those handled by a TPA/MGA) to determine whether claims subject to reinsurance were appropriately identified.</td>
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Significant reinsurance recoverables are CR EX VA PD RRC The insurer continually monitors the financial solvency of its reinsurers Review assessments of the reinsurance review performed by Perform procedures related to the NAIC Examination Jumpstart approach to test
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<td>overstated or not collectible.</td>
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<td>throughout the duration of the reinsurance contracts.</td>
<td>internal/external auditors, reinsurers and/or others for significant issues.</td>
<td>whether the level of ceded recoverables are reasonably equivalent to the level of assumed liabilities reported by the assuming reinsurers.</td>
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<td>The insurer maintains records of its reinsurance recoverables, prepares aging reports and follows up on any past-due amounts in a timely manner.</td>
<td>Obtain documented review of aging reports and support for the collectability of any delinquent uncollected amounts.</td>
<td>Obtain and analyze recent financial information of the assuming (re)insurer (e.g., annual financial statement, SEC filings, etc.) or results of insurance industry reporting and rating services (e.g., A.M. Best, S&amp;P, FAST tools, etc.) to determine the credit worthiness of significant reinsurers.</td>
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<td>Perform procedures to determine the collectability/existence of reinsurance recoverable balances:</td>
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<td>• Select a sample of reinsurance recoverable balances and trace to subsequent collection in order to ascertain collectability; or,</td>
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<td>• For a sample of reinsurance recoverable balances, agree the balance to a valid reinsurance</td>
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<tr>
<td>Funds held as security for XXX/AXXX transactions are not adequate to support the reserve.</td>
<td>CR VA CM AARP RA</td>
<td>The insurer periodically reviews the underlying security for XXX/AXXX transactions for compliance with applicable state investment laws for the ceding insurer and SSAPs. For transactions subject to AG 48, the insurer’s appointed actuary conducts an analysis of XXX/AXXX reinsurance arrangements on a treaty-by-treaty basis to determine that funds consisting of Primary Security and Other Security are appropriately held by or on behalf of the ceding insurer or that the insurer has established a liability in accordance with AG 48.</td>
<td>Verify that a review of the underlying security for XXX/AXXX transactions is conducted on a periodic basis and subject to management review and approval. Obtain the analysis prepared by the insurer’s appointed actuary and verify management review and approval.</td>
<td>Review the investment portfolio of the ceding insurer to determine compliance with applicable state investment laws for the ceding insurer and SSAPs. For a sample of reinsurance policies not subject to AG 48, review the funds held by or on behalf of the ceding insurer as security for the reinsurance transaction to determine compliance with applicable state investment laws for the ceding insurer and SSAPs. Consider requesting an asset/liability matching run on a standalone basis for all business issued through a reinsurance financing agreement.</td>
<td>contract, noting whether reinsurance premiums have been paid; the claims are covered under the reinsurance contract; the deductible payments by the ceding insurer have been met; and the balance has been netted against indemnity and paid LAE amounts previously recovered from the reinsurer.</td>
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<tr>
<td>The insurer is not properly calculating the provision for reinsurance. <em>(P&amp;C Companies)</em></td>
<td>OP</td>
<td>AC VA EX CM PD</td>
<td>RRC</td>
<td>The insurer has policies in place to determine whether reinsurers are authorized, unauthorized or certified. A provision for reinsurance is completed for unauthorized and certified reinsurers in accordance with SAP. The insurer maintains and verifies adequacy of funds held, letters of credit, trust account balances or any other forms of collateral. The insurer has controls in place to reconcile the recoverable balances, agings, amounts in dispute and offset payable balances used in the provision calculation to those amounts reported in the general ledger and accounting system. The provision for reinsurance calculation is</td>
<td>Obtain documentation relating to authorized, unauthorized and certified reinsurers. Review company support for reinsurer status and evidence of provision calculation and review. Obtain evidence of insurer verification of funds held, letters of credit, trust account balances or any other forms of collateral. Obtain and review the completed reconciliations. Test any significant reconciling items for appropriateness. Obtain evidence of management review.</td>
<td>Verify authorization and certified reinsurer status for reinsurers included in the provision for reinsurance calculations. Review the letters of credit to verify whether they are clean, irrevocable and issued by a qualified U.S. financial institution, as defined in Appendix A-785 of the <em>Accounting Practices and Procedures Manual</em>. Verify the existence and adequacy of funds held, trust account balances or any other forms of collateral. Verify whether the trustee is a qualified U.S. financial institution and that the form of the trust and amounts comply with the laws and regulations of the state of the ceding insurer’s commissioner.</td>
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<tr>
<td>Insurer is taking credit for reinsurance contracts with unauthorized reinsurers. (Non-P&amp;C Companies)</td>
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<td>reviewed by management to ensure accuracy.</td>
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<td>Identify any significant amounts included in the calculation not previously examined. Perform procedures to ascertain the validity of the amounts and their utilization in the calculation. Recalculate the provision for reinsurance.</td>
</tr>
<tr>
<td>The insurer is overestimating the reinsurance recoverable credit on incurred but not reported (IBNR) loss and IBNR LAE reserves.</td>
<td>OP VA AC RRC</td>
<td></td>
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<td>The insurer has processes in place to segregate authorized, unauthorized and certified reinsurer contracts in accordance with the requirements set forth in Appendix A-785 – Credit for Reinsurance. The insurer includes appropriate collateral requirement provisions in all contracts with unauthorized and certified reinsurers. The insurer has procedures in place to monitor and obtain additional collateral as it becomes necessary to do so.</td>
<td>Perform a walkthrough to gain an understanding of the insurer’s process to segregate authorized, unauthorized and certified reinsurer contracts. Obtain contracts to determine whether provision for collateral requirement is included and adequate. Test the company’s processes to review and adjust collateral balances as necessary.</td>
<td>Perform procedures to verify that reserve credits are taken appropriately under the requirements of Appendix A-785 of the Accounting Practices and Procedures Manual or applicable state laws and regulations. For example, verify the amount and validity of collateral held in support of credits taken. Consider the reasonableness of reinsurance credits taken, recoverables for IBNR loss and IBNR LAE reserves, based on a review of the insurer’s reinsurance program and treaties in place.</td>
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<td>(See also Examination Repository – Reserves/Claims Handling)</td>
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<td>The insurer’s appointed actuary is involved in calculating and/or estimating/reviewing the recoverable credit amount.</td>
<td>appointed actuary, management approval and sign-off.</td>
<td>Utilize the insurance department actuary or an independent actuary to review the reasonableness of ceded reinsurance estimates included in the opining actuary’s report.</td>
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<td>Compare the credit recoverable amounts recorded by the insurer to reinsurers’ estimated liability, if available.</td>
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<td>Recalculate or test actual credits taken on a sample of contracts and verify whether the ceding insurer is correctly applying the terms.</td>
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Annual Statement Blank Line Items

Listed below are the corresponding Annual Statement line items that are related to the identified risks contained in this exam repository:

- Reinsurance Payable on Paid Loss and Loss Adjustment Expenses
- Funds Held by the Company Under Reinsurance Treaties
- Contract Liabilities Not Included Elsewhere – Other Amounts Payable on Reinsurance
- Commissions and Expense Allowances Payable on Reinsurance Assumed

Relevant Statements of Statutory Accounting Principles (SSAPs)

All of the relevant SSAPs related to the reinsurance process, regardless of whether or not the corresponding risks are included within this exam repository, are listed below:

No. 5R  Liabilities, Contingencies and Impairments of Assets – Revised
No. 6  Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due from Agents and Brokers
No. 25  Affiliates and Other Related Parties
No. 61R  Life, Deposit-Type and Accident and Health Reinsurance – Revised
No. 62R  Property and Casualty Reinsurance – Revised
No. 63  Underwriting Pools
No. 64  Offsetting and Netting of Assets and Liabilities
No. 65  Property and Casualty Contracts
<table>
<thead>
<tr>
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<tr>
<td>Other Than Financial Reporting Risks</td>
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<td>The (re)insurer has a documented strategy that indicates the type of reinsurance to be offered and the guidelines for ceding companies to meet, which is approved by the board of directors (or committee thereof).</td>
<td>Review meeting minutes of the board of directors (or committee thereof) or other evidence of board involvement in the approval of the (re)insurer’s reinsurance strategy.</td>
<td>Review assuming agreements to determine whether the lines, types and limits of business assumed conform to the (re)insurer’s reinsurance strategy.</td>
</tr>
<tr>
<td>The (re)insurer does not have or is not complying with its reinsurance strategy.</td>
<td>OP ST</td>
<td>Other</td>
<td>UPSQ</td>
<td>The (re)insurer has a formal process in place to review and approve reinsurance agreements for compliance with the company’s documented strategy.</td>
<td>Obtain and review documented reinsurance strategy.</td>
<td>Select a sample of new reinsurance contracts for evidence of review and approval in accordance with the insurer’s process.</td>
</tr>
<tr>
<td>The (re)insurer is not properly evaluating and monitoring the ceding insurer for compliance with guidelines outlined in the reinsurance strategy.</td>
<td>OP ST</td>
<td>Other</td>
<td>UPSQ</td>
<td>Prior to entering into contracts, the (re)insurer performs due diligence on the potential ceding insurers to ensure compliance with the reinsurer’s underwriting and claims practices. Throughout the term of the contract, the (re)insurer periodically reviews the underwriting practices and evaluates the underwriting and claims results of ceding insurers through analytical reviews and/or quality assurance (QA) reviews.</td>
<td>Obtain documentation of the (re)insurer’s due diligence and consider whether the work completed is appropriate.</td>
<td>Obtain documentation of the (re)insurer’s periodic reviews of ceding insurers.</td>
</tr>
<tr>
<td>The (re)insurer does not collect accurate and complete loss exposure data from</td>
<td>OP ST</td>
<td>Other</td>
<td>UPSQ AARP RD</td>
<td>The (re)insurer has a process in place to review and accumulate loss exposure data reported by</td>
<td>Review and test the operating effectiveness of the (re)insurer’s processes to review and accumulate</td>
<td>Analytically review the loss exposure data reported by ceding insurers/brokers to identify potential</td>
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<tr>
<td>ceding insurers/brokers. (See also Examination Repository – Reserves/Claims Handling.)</td>
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<td></td>
<td>its ceding insurer/brokers.</td>
<td>loss exposure data reported by ceding insurers/brokers.</td>
<td>inconsistencies.</td>
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<td>• The process includes consistency checks/variance analysis in reviewing reported data; and</td>
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<td>If deemed necessary, perform additional procedures to get comfort with the loss exposure data reported to the (re)insurer from ceding insurers/brokers.</td>
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<td>• The (re)insurer conducts periodic audits of ceding companies to review reported loss exposure data and other significant reporting elements.</td>
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<td>The (re)insurer has not established and maintained appropriate risk exposure limits for assuming reinsurance.</td>
<td>OP ST</td>
<td>Other</td>
<td>UPSQ</td>
<td>The (re)insurer has established and documented risk exposure limits by geography and/or line of business that have been reviewed and approved by senior management.</td>
<td>Review documentation of risk exposure limits and evidence of senior management review/approval.</td>
<td>If necessary, recalculate the aggregate loss exposures by reviewing data reported by ceding insurers/brokers.</td>
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<td>The (re)insurer utilizes a fully staffed, well-qualified reinsurance department that has experience in all lines of business and geographic locations served by the (re)insurer.</td>
<td>Review the credentials, background and responsibilities of the senior personnel managing the insurer’s reinsurance function.</td>
<td>Utilize audit software to review the (re)insurer’s risk exposures (e.g., summarize policies by ZIP code, industry code, policy size, etc.) for compliance with insurer limits. If the (re)insurer has not identified risk exposure limits, test the risk exposures for appropriateness by considering industry standards.</td>
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<td>The (re)insurer accumulates assumed loss exposure data and utilizes data models to track compliance with exposure limits established by the (re)insurer.</td>
<td>Test the operating effectiveness of the (re)insurer’s controls to accumulate loss exposure data and track compliance with the exposure limits by reviewing the modeling process.</td>
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<tr>
<td>The (re)insurer is not monitoring financial results for financially</td>
<td>OP ST</td>
<td>Other</td>
<td>UPSQ</td>
<td>The (re)insurer has procedures in place governing comparison of assumed loss exposure data and utilizes data models to track compliance with exposure limits established by the (re)insurer.</td>
<td>Obtain documentation of ongoing monitoring of reinsurance results.</td>
<td>Review treaty files for evidence of ongoing review process.</td>
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<td>significant assumed contracts.</td>
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<td>actual vs. expected for financially significant contracts.</td>
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<td>Perform analytical procedures to ensure that significant contracts do not represent a future solvency risk.</td>
</tr>
<tr>
<td>The (re)insurer does not effectively oversee its reinsurance intermediaries to ensure that they are complying with the intermediary agreement.</td>
<td>OP CR</td>
<td>Other UPSQ</td>
<td></td>
<td>The reinsurer has a written agreement with the intermediary to document the responsibilities of each party.</td>
<td>Review the documentation that provides evidence that a written contract is received and approved.</td>
<td>Review the results of audits performed by the intermediaries (audits of ceding insurers). If deemed necessary, perform a site visit to audit the intermediary’s processes and transactions.</td>
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<tr>
<td>Financial Reporting Risks</td>
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<tr>
<td>Reinsurance contracts are not completed and accounted for in compliance with statutory accounting principles (SAP) and applicable state requirements.</td>
<td>LG PD EX OB/OW RRC</td>
<td></td>
<td>RRC</td>
<td>The reinsurer evaluates all reinsurance contracts to ensure that there is adequate transfer of risk in compliance with SAP.</td>
<td>Gain an understanding of the (re)insurer’s processes for the review of reinsurance contracts and examine contracts for evidence of evaluation. For P&amp;C insurers, review the insurer’s policies and procedures in place to 1) determine how the reinsurance agreement is accounted for (prospective, retroactively or deposited in accordance with SSAP No. 62R); and 2) ensure the</td>
<td>For all significant contracts, determine whether the contracts include appropriate clauses and transfer risk in accordance with SAP. Use Exhibit N, Part Three to assist in this process. If a contract does not transfer risk, verify that it has received deposit accounting treatment in accordance with SAP.* For a sample of P&amp;C reinsurance contracts, determine whether the</td>
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<td>Identified Risk</td>
<td>Possible Controls</td>
<td>Possible Test of Controls</td>
<td>Possible Detail Tests</td>
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<td><strong>Assuming Insurer</strong></td>
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<td><strong>RV</strong></td>
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<td><strong>RD</strong></td>
<td><strong>RRC</strong></td>
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</table>

- **The assuming insurer has procedures in place to ensure that reinsurance contracts are finalized, reduced to written form and signed in accordance with applicable SSAPs.**
  - For P&C insurers, contracts must be executed within nine months of the effective date or accounted for retroactively in accordance with SSAP No. 62R.
  - For life insurers, credit for reinsurance is not authorized if the agreement, amendment or binding letter of intent is not executed by both parties by the "as-of" date of the financial statement in accordance with Appendix A-791.

- **The (re)insurer has written guidelines/procedures specifying acceptable documentation, review and approval of reinsurance contracts.**
  - The (re)insurer has procedures in place that define the specific authority levels of designated personnel who are authorized to commit the corporation to new reinsurance contracts.
  - Ensure that only authorized personnel are committing the insurer to reinsurance contracts.

- **Review a selection of contracts to:**
  - Ensure that only authorized personnel are committing the insurer to reinsurance contracts.
  - Ensure that the appropriate documentation and approvals are in place.
  - Determine whether they have been reviewed by the (re)insurer.

- **Utilize NAIC Examination Jumpstart reports to identify instances where material assumed reinsurance liabilities have not been included in the assuming insurer’s financial statements.**

- **For a sample of life reinsurance contracts, determine whether the effective date and the execution date fall within Appendix A-791 requirements.**

- **For life insurers, review the insurer’s policies and procedures in place to ensure compliance with Appendix A-791.**

- **The (re)insurer has written procedures in place that define the specific authority levels of designated personnel who are authorized to commit the corporation to new reinsurance contracts.**

- **Ensure that only authorized personnel are committing the insurer to reinsurance contracts.**

- **Determine whether they have been reviewed by the (re)insurer.**
<table>
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<tr>
<th>Identified Risk</th>
<th>Branded Risk</th>
<th>Exam Asrt.</th>
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<th>Possible Controls</th>
<th>Possible Test of Controls</th>
<th>Possible Detail Tests</th>
</tr>
</thead>
<tbody>
<tr>
<td>Reinsurance contracts with affiliates have not been filed in accordance with applicable state statutes and do not have equitable contract provisions.</td>
<td>OP ST CM AC AARP RPHCC</td>
<td></td>
<td></td>
<td>approval required before a contract may be accepted. The (re)insurer has procedures in place to ensure review of all contracts by the accounting department to ensure proper reporting.</td>
<td>the accounting department for purposes of determining the proper accounting treatment.</td>
<td>Review the insurer’s policies and procedures in place to ensure such policies adhere to applicable statutes and would adequately identify transactions requiring a filing. Test the (re)insurer’s processes to ensure that transactions with related parties are negotiated at arm’s length by obtaining evidence of senior management review and approval and support for the appropriateness of ceding commissions, risk transfer and adequate pricing. Obtain and review the significant contracts between the (re)insurer and its affiliates and ensure that agreements are filed with the insurance department in accordance with applicable state requirements. Verify that the (re)insurer is operating in accordance with approved contract terms. Review contract provisions for reasonableness through conducting analytical procedures such as reviewing the profitability of business assumed from affiliates and/or comparing commissions paid to the ceding insurer’s expense ratio or comparing actual to expected results. Consider involving a reinsurance expert or actuarial examiner to review complex contracts and/or those with questionable...</td>
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<tr>
<td>Identified Risk</td>
<td>Branded Risk</td>
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<td></td>
<td>contract execution to ensure that policies are enforced.</td>
<td>provisions. Consider performing independent testing to evaluate the reasonableness of contract pricing and terms.</td>
<td></td>
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</tbody>
</table>
Own Risk and Solvency Assessment (ORSA)

During the review of the ORSA filing (if applicable), the examiner may identify risks and controls that are relevant to be considered when creating the Capital and Surplus Key Activity Matrix. Additionally, examiners may perform test procedures related to the information contained within the ORSA filing that provides evidence regarding the sufficiency of an insurer’s capital and surplus. Examiners are encouraged to leverage the information contained within the ORSA, and associated test procedures, when populating the Key Activity Matrix.

Annual Statement Blank Line Items

Listed below are the corresponding Annual Statement line items that are related to the identified risks contained in this exam repository:

- Capital Notes and Interest Thereon
- Aggregate Write-ins for Special Surplus Funds
- Common Capital Stock
- Preferred Capital Stock
- Aggregate Write-ins for Other than Special Surplus Funds
- Surplus Notes
- Gross Paid-in and Contributed Surplus
- Unassigned Funds (Surplus)
- Treasury Stock

Relevant Statements of Statutory Accounting Principles (SSAPs)

All of the relevant SSAPs related to other liabilities and surplus, regardless of whether or not the corresponding risks are included within this exam repository, are listed below:

- No. 41 Surplus Notes
- No. 72 Surplus and Quasi-reorganizations
<table>
<thead>
<tr>
<th>Identified Risk</th>
<th>Branded Risk</th>
<th>Exam Asrt.</th>
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<th>Possible Test of Controls</th>
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<tr>
<td><strong>Other Than Financial Reporting Risks</strong></td>
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<tr>
<td>The insurer is not monitoring its capital and surplus needs, including how changes may impact RBC and financial strength ratings from rating agencies.</td>
<td>LQ</td>
<td>Other</td>
<td>CMT</td>
<td>Management performs capital modeling calculations, including assessing capital and liquidity needs in normal and stressed environments, to understand the insurer’s current and prospective capital needs.</td>
<td>Obtain evidence of the capital modeling calculations performed by management, including self-validation efforts.</td>
<td>Consider utilizing an actuarial specialist to assist with detail test procedures.</td>
</tr>
<tr>
<td><strong>Please Note:</strong> Examiners should utilize information contained in the Own Risk and Solvency Assessment (ORSA) provided by insurers that are subject to this filing requirement.</td>
<td></td>
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<td>The board of directors (or committee thereof) reviews and approves the capital modeling results performed by management on an annual basis.</td>
<td>Review the board of directors’ (or committee thereof) meeting minutes for evidence of the board’s approval of the capital modeling results.</td>
<td>Consider applying a wide range of scenarios, including severely stressed scenarios, to verify the insurer’s available capital is adequate to meet its current and prospective capital needs. Consider the impact of different scenarios on RBC and/or rating agency assessments.</td>
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<td>Management prepares financial projections that include investment, underwriting and expenses, and their projected impact on surplus.</td>
<td>Obtain evidence of financial projections and planning by management.</td>
<td>Review the insurer’s capital modeling and evaluate the appropriateness of input assumptions, methodologies and considerations used in quantifying available capital and risk capital. In the case of stochastic or deterministic modeling, document consideration of appropriateness of diversification of risks.</td>
</tr>
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<td>Financial projections are reviewed by the board of directors.</td>
<td>Review the board of director meeting minutes for evidence of board review and approval.</td>
<td>Review the underlying assumptions found in the financial projections for reasonableness. Review prior year projections for a comparison of assumptions and whether management is historically on target.</td>
</tr>
<tr>
<td>The insurer does not have access to</td>
<td>ST</td>
<td>Other</td>
<td>CMT</td>
<td>Management performs ongoing analysis of various</td>
<td>Review documentation describing the insurer’s</td>
<td>Perform a review of management’s available</td>
</tr>
<tr>
<td>Identified Risk</td>
<td>Branded Risk</td>
<td>Exam Asrt.</td>
<td>Critical Risk</td>
<td>Possible Controls</td>
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<td>sufficient capital to support its ongoing and future business needs.</td>
<td></td>
<td></td>
<td></td>
<td>sources of capital (e.g., issuing bonds, selling common stock, parent contributions, borrowing, etc.) to ensure the insurer maintains a current understanding of the options available.</td>
<td>overall capital management strategy and the options available to raise capital.</td>
<td>sources of capital and assess the feasibility of each option to confirm the insurer has access to sufficient capital, should the need arise.</td>
</tr>
<tr>
<td><strong>Please Note:</strong> Examiners should utilize information contained in the Own Risk and Solvency Assessment (ORSA) provided by insurers that are subject to this filing requirement.</td>
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<td><strong>Please Note:</strong> When the source of capital is from an affiliate, consider testing in conjunction with the Related Party Repository. Review the board of directors’ (or committee thereof) meeting minutes for evidence of the Board’s approval of the overall capital strategy plan and the various options available to raise capital, should the need arise.</td>
<td><strong>Please Note:</strong> When the source of capital is from an affiliate, consider testing in conjunction with the Related Party Repository.</td>
</tr>
<tr>
<td>The insurer is not effectively managing its gross leverage.</td>
<td>ST LQ CR</td>
<td>Other AARP</td>
<td></td>
<td>The insurer has established and documented gross leverage limits that are reviewed and approved by senior management. The insurer periodically evaluates its gross leverage and adjusts, as needed.</td>
<td>Review documentation of gross leverage limits and evidence of senior management review/approval.</td>
<td>Review the reasonableness of the insurers gross leverage limit by benchmarking against industry standards.</td>
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<tr>
<td><strong>Financial Reporting Risks</strong></td>
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<tr>
<td>The underlying quality of the company’s capital is not sufficient to support its ongoing and future business operations.</td>
<td>LQ CR OP AC EX VA PD CMT</td>
<td></td>
<td>The insurer monitors assets to ensure the quality of capital will support its ongoing business needs. Underlying assets to be considered may include: • Deferred tax assets • Significant receivables • Goodwill • Investment in subsidiary • Encumbered assets</td>
<td>Verify the insurer’s process to monitor the quality of underlying assets in relation to required capital needs.</td>
<td>Verify the accuracy of reported amounts for selected assets to determine the quality as they support the insurer’s surplus. Include consideration of the liquidity of the assets under review.</td>
<td>Review the make-up of the insurer’s capital and assess</td>
</tr>
<tr>
<td>Identified Risk</td>
<td>Branded Risk</td>
<td>Exam Asrt.</td>
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<tr>
<td>The insurer is not accurately calculating, reporting and monitoring RBC.</td>
<td>OP</td>
<td>CM</td>
<td>CMT</td>
<td>RBC calculations are performed in accordance with instructions and subject to supervisory review.</td>
<td>Test controls relating to the insurer’s supervisory review process for RBC.</td>
<td>Obtain and review the insurer’s supporting workpapers to test whether material values in the RBC report were properly classified, valued and included (e.g., catastrophe risk exposure data, C-3 Phase II). (This procedure may only be necessary for values not obtained directly from the annual financial statement and not subject to the NAIC RBC crosscheck procedures.)</td>
</tr>
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<td>The company has a process to ensure that RBC reports and supporting data are filed with the NAIC in a timely and complete manner.</td>
<td>Review the NAIC RBC crosscheck letter from the insurer or the NAIC, if applicable, and response letter from the insurer to determine the completeness and accuracy of the insurer’s RBC report. Contact the NAIC quality assurance department if such correspondence is unavailable.</td>
<td>Determine the impact of examination changes on the RBC calculation.</td>
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<tr>
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<td>The company reconciles data filed in support of the RBC calculation back to</td>
<td>Test the insurer’s reconciliation of supporting data back to the system</td>
<td>Compare the modeling approaches, assumptions</td>
</tr>
</tbody>
</table>

- Defined benefit pension asset

The insurer maintains documentation regarding permitted practices that could impact the quality of available capital and reviews all associated calculations to ensure compliance.

Obtain documentation of the insurer’s review of its compliance with permitted practices.

how the categories (e.g., common stock, preferred stock, surplus notes, paid-in-capital, etc.) support the ongoing and future business operations.

Review the insurer’s calculations to ensure they comply with the permitted practices granted by the domiciliary insurance commissioner. Review the effects of the permitted practice on RBC calculations, including subsequent examination adjustments.

Obtain and review the insurer’s supporting workpapers to test whether material values in the RBC report were properly classified, valued and included (e.g., catastrophe risk exposure data, C-3 Phase II). (This procedure may only be necessary for values not obtained directly from the annual financial statement and not subject to the NAIC RBC crosscheck procedures.)

Determine the impact of examination changes on the RBC calculation.

Compare the modeling approaches, assumptions.
<table>
<thead>
<tr>
<th>Identified Risk</th>
<th>Possible Controls</th>
<th>Possible Test of Controls</th>
<th>Possible Detail Tests</th>
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<td>Critical Risk</td>
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<td>Binded Risk</td>
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The company utilizes the same modeling approach, assumptions and data to determine significant components of its RBC charge (e.g., catastrophe risk exposure, C-3 Phase II) as it uses for its own internal risk management and regulatory accounting/reserving purposes. Test the operating effectiveness of company controls to verify that modeling approaches, assumptions and data used to determine significant components of RBC charges are reconciled/agreed to those used in internal risk management and accounting/reserving processes. Investigate any significant variances for appropriateness.
Identification of Risks:

To ensure that the examiner appropriately identifies and addresses all relevant risks, it is important that examiners consider information contained within the Own Risk and Solvency Assessment (ORSA), Group Profile Summary (GPS), and insights shared from the Department’s Financial Analysts. An understanding of the group, including the Ultimate Controlling Party, will provide the examiner with a roadmap to help in effectively addressing the risks posted to the insurer by its related parties.

Annual Statement Blank Line Items

Listed below are the corresponding Annual Statement line items that are related to the identified risks contained in this exam repository:

- Receivables from Parent, Subsidiaries and Affiliates
- Payable to Parent, Subsidiaries and Affiliates
- Amount Provisionally Held for Deferred Dividend Policies (*Life Companies*)
- Dividends to Stockholders Declared and Unpaid (*Life Companies*)

Please Note:

- Transactions resulting from related party tax sharing and reinsurance agreements are typically reported on the appropriate tax and reinsurance financial statement line items, which are not listed above.
- The examiner should consider the company’s compliance with the state statutory guidelines when reviewing affiliate and other related-party contracts.
- For additional guidance on related party and intercompany transactions, see Section 1, Part IV, D - Review of Affiliated Transactions.

Relevant Statements of Statutory Accounting Principles (SSAPs)

All of the relevant SSAPs related to the related party process, regardless of whether or not the corresponding risks are included within this exam repository, are listed below:

- No. 15 Debt and Holding Company Obligations
- No. 25 Affiliates and Other Related Parties
- No. 64 Offsetting and Netting of Assets and Liabilities
- No. 67 Other Liabilities
- No. 70 Allocation of Expenses
- No. 97 Investments in Subsidiary, Controlled and Affiliated Entities
<table>
<thead>
<tr>
<th>Identified Risk</th>
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<tr>
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<tr>
<td>A related party (including holding company) is overly reliant on the insurer for ongoing surplus support. Affiliated companies are overly reliant on dividends paid by the insurer.</td>
<td>ST</td>
<td>Other</td>
<td>RPHCC</td>
<td>Review insurer documentation showing that dividends are within regulatory limits, do not cause a liquidity strain on the insurer, are approved by the board of directors (or committee thereof) and have received regulatory approval (if required) prior to payment.</td>
<td>Assess the insurance holding company organization’s structure, overall group structure and the holding company’s reliance on its subsidiaries for dividends. Consider the profitability and success of other companies within the holding company, as well as capital resources and debt maturities as part of the assessment. Review historical cash flows from the insurer to its affiliated companies since the last examination, and compare to statutory dividend capacity currently available. Trace all dividends requiring regulatory approval to insurance department documentation.</td>
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</tr>
<tr>
<td>The insurer monitors the financial position of the affiliate providing surplus support. The affiliate provides a guarantee of its ongoing support for the insurer. The insurer monitors all guarantee agreements and</td>
<td>OP</td>
<td>Other</td>
<td>RPHCC</td>
<td>Management reviews financial results of the affiliate on a quarterly or annual basis. Obtain documentation supporting the guarantee provided by the affiliate. Verify that</td>
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<td><strong>Please Note:</strong> Review of this risk should be performed in conjunction with the Capital and Surplus Repository.</td>
<td>CR</td>
<td>LQ</td>
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Comment [NAIC1]: Moved from FR section of repository.
<table>
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<th>Identified Risk</th>
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<th>Possible Test of Controls</th>
<th>Possible Detail Tests</th>
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</thead>
<tbody>
<tr>
<td>Parent, holding companies or other affiliates might become insolvent or have liquidity issues.</td>
<td>ST</td>
<td>Other</td>
<td>RPHCC</td>
<td><strong>Please Note:</strong>&lt;br&gt;This risk is intended to focus on the strategic or reputational impact if affiliates experience solvency or liquidity issues.</td>
<td>Evaluate the possibility the guarantee will not be fulfilled and the potential impact to the insurer.</td>
<td>Verify any collateral maintained in accordance with the guarantee.</td>
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<tr>
<td>Management performs an assessment of the guarantor’s ability to fulfill the agreement on a periodic basis.</td>
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<td>management performs an assessment of the guarantor’s ability to fulfill the agreement if necessary.</td>
<td>Observe the possibility the guarantee will not be fulfilled and the potential impact to the insurer.</td>
<td>Obtain and review parent or holding company financial information (including the Enterprise Risk Report ORSA if available) for indications of financial solvency or liquidity issues. If significant issues are identified, perform procedures to evaluate the potential solvency impacts. If necessary, notify the financial analyst of the concern and request additional monitoring of the insurer.</td>
</tr>
<tr>
<td>The insurer monitors parent or holding companies for financial solvency/liquidity issues.</td>
<td>ST</td>
<td>Other</td>
<td>RPHCC</td>
<td>Obtain evidence of review of parent or holding company financial information by the insurer. Ensure liquidity is appropriately considered.</td>
<td>Obtain and review parent or holding company financial information (including the Enterprise Risk Report ORSA if available) for indications of financial solvency or liquidity issues. If significant issues are identified, perform procedures to evaluate the potential solvency impacts. If necessary, notify the financial analyst of the concern and request additional monitoring of the insurer.</td>
<td></td>
</tr>
<tr>
<td>The insurer monitors parent or holding companies for financial solvency/liquidity issues.</td>
<td>ST</td>
<td>Other</td>
<td>RPHCC</td>
<td>Review meeting minutes of the board of directors (or committee thereof) for evidence of discussions and actions taken to mitigate any contagion risks.</td>
<td>Obtain and review parent or holding company financial information (including the Enterprise Risk Report ORSA if available) for indications of financial solvency or liquidity issues. If significant issues are identified, perform procedures to evaluate the potential solvency impacts. If necessary, notify the financial analyst of the concern and request additional monitoring of the insurer.</td>
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</table>

**Please Note:**<br>This risk is intended to focus on the strategic or reputational impact if affiliates experience solvency or liquidity issues. 

Comment [NAIC2]: Moved down to be closer to similar risks on allocation of expenses.
<table>
<thead>
<tr>
<th>Identified Risk</th>
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<th>Possible Test of Controls</th>
<th>Possible Detail Tests</th>
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</thead>
</table>
| The insurer is not properly identifying related-party activities. | OP ST | AC VA PD CM CO | RPHCC | The insurer maintains a list of all related parties — including pension funds and other trusts established for employees, major borrowers and lenders, and significant agents, brokers, producers and providers — that is approved by management and provided to key employees. As significant transactions occur, management considers whether new related party relationships have been established which are then added to the list of related parties. | Obtain the related-party listing and verify/assess the method management uses to ensure completeness and utilization of the list. | Perform procedures to identify related parties such as:  
- Reviewing minutes  
- Reviewing shareholder listings of closely held companies to identify principal shareholders  
- Reviewing material investment transactions during the period under examination to determine whether they cause another entity to become a related party. |

**Comment [NAIC3]**: Procedures moved from risk below.

**Comment [NAIC4]**: Added new control and test of control to address gap.
<table>
<thead>
<tr>
<th>Identified Risk</th>
<th>Branded Risk</th>
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<th>Possible Test of Controls</th>
<th>Possible Detail Tests</th>
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</thead>
<tbody>
<tr>
<td>The insurer is not properly identifying, recording and disclosing related-party activities.</td>
<td>OP ST</td>
<td>AC VA PD CM</td>
<td>RPHCC</td>
<td>The insurer maintains a list of all related parties— including pension funds and other trusts established for</td>
<td>Obtain the related-party listing and verify the method management uses to ensure</td>
<td>Prepare a list of entities and/or persons that appear to be related parties and compare to management’s listing, if one exists. Ask management about the insurer’s relationships with these entities and/or persons. Determine whether the entities and/or persons meet the definition of a “related party” under the domiciliary state’s insurance code.</td>
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</table>

- Reviewing conflict-of-interest statements obtained by the entity from management and directors.

- Reviewing accounting records for large, unusual or non-recurring transactions or balances, paying particular attention to transactions recognized at or near the end of the accounting period, which may indicate transactions with related parties that should be disclosed.

Comment [NAIC5]: Moved from below with minor wording revision.
<table>
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<th>Identified Risk</th>
<th>Branded Risk</th>
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<td>employees, major</td>
<td>completeness and</td>
<td>insurer’s relationships</td>
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For identified related parties, the insurer maintains records (e.g. consolidated schedule of intercompany allocations, balances, etc.) so that individual allocations and balances are easily identifiable in the aggregate intercompany balances and amounts that have been offset are identifiable.

The insurer has procedures, including supervisory review, in place to ensure that all related-party activities are properly disclosed and reported.

Management reviews contract terms periodically to ensure that they are
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<tr>
<th>Identified Risk</th>
<th>Branded Risk</th>
<th>Exam Asrt.</th>
<th>Critical Risk</th>
<th>Possible Controls</th>
<th>Possible Test of Controls</th>
<th>Possible Detail Tests</th>
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<tbody>
<tr>
<td>The insurer is overly reliant on an affiliate for ongoing surplus support.</td>
<td>OP ST CR OB OW VA RPHCC</td>
<td>OP ST CR OB OW VA RPHCC</td>
<td>OP ST CR OB OW VA RPHCC</td>
<td>The insurer monitors the financial position of the affiliate providing surplus support. The affiliate provides a guarantee of its ongoing support for the insurer. The insurer monitors all guarantee agreements and</td>
<td>Management reviews financial results of the affiliate on a quarterly or annual basis. Obtain documentation supporting the guarantee provided by the affiliate.</td>
<td>Review the affiliate’s financial position to determine the ability to provide the needed support. Compare the amount guaranteed by the parent/affiliate with the surplus of the insurer receiving the guarantee.</td>
</tr>
</tbody>
</table>

*Please Note: Review of this risk should be performed in conjunction with the Capital and Surplus Repository.*

The insurer has a process that identifies transactions that are subject to regulator approval and ensures that transactions are approved as appropriate.

The insurer has a policy in place that requires written approval from the board of directors (or committee thereof) prior to entering into any loan transaction (lending or borrowing), or guarantees (parental/affiliated surplus support or loan repayment/collateralization) to ensure that transactions meet “fair and reasonable” and “arm’s-length” standards.

Review a sample of past transactions to confirm management’s process was executed, as appropriate.

Review meeting minutes of the board of directors (or committee thereof) for evidence of written approval of related-party loans or guarantees.

whether the transactions are subject to any prior approval requirements in the domiciliary state’s insurance code.

Review the contracted transactions with affiliates and determine whether they are at arm’s length and properly reported as economic or non-economic, in accordance with SSAP No. 25.

Obtain the loan document(s) or written guarantee and verify that the terms of the contract are equitable and reasonable. Verify the guarantee or loan was properly disclosed in the annual financial statement and filed with the domiciliary state insurance department, if applicable.

Comment [NAIC6]: Moved up to be closer to similar risks.
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<th>Identified Risk</th>
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<tr>
<td>The insurer is not properly disclosing loans and/or guarantees with affiliates</td>
<td>OP ST OR OW PD</td>
<td>RPHCC</td>
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<td>analyzes the guarantor’s ability to fulfill the agreement if necessary.</td>
<td>management performs an assessment of the guarantor’s ability to fulfill the agreement on a periodic basis.</td>
<td>Evaluate the possibility the guarantee will not be fulfilled and the potential impact to the insurer. Verify any collateral maintained in accordance with the guarantee.</td>
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<tr>
<td>The insurer engages in transactions with affiliates that have inequitable terms.</td>
<td>OP CM</td>
<td>RPHCC</td>
<td></td>
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<td>Select a sample of agreements and transactions for review to verify the agreements are consummated at arm’s length and the transactions are in accordance with the agreements.</td>
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Comment [NAIC7]: Moved above.

Comment [NAIC8]: Risk was moved from above to be paired with similar risks.
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<tr>
<td>Intercompany allocation of general and administrative expenses among affiliates is inappropriate.</td>
<td>OP</td>
<td>VA PD</td>
<td>RPHCC</td>
<td>Management reviews cost-allocation contracts to ensure that the basis for expense allocation is fair and reasonable. Expenses to be allocated are identified and reasonable metrics are defined, developed and used for each type of expense. Management also reviews the basis of allocation periodically to ensure that it is still reasonable and properly reflects current operations.</td>
<td>Review the insurer’s expense allocation worksheets and determine whether the method of allocation follows the contract and is reasonable. Inquire with management regarding changes in operations that might affect expense allocation and verify that those changes are properly reflected.</td>
<td>Test the insurer’s calculation of material expense allocation for compliance with the terms of the contract. Reconcile amounts to the general ledger and Underwriting &amp; Investment Exhibit, Part 3, and trace to receipt or payment documentation as applicable.</td>
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<td>Intercompany allocation of tax expenses among affiliates is inappropriate.</td>
<td>OP</td>
<td>AC CO</td>
<td>RPHCC</td>
<td>The insurer has a policy in place to disclose the names of the entities with whom the entity’s tax return is consolidated, in accordance with statutory accounting principles (SAP) and applicable tax law. The insurer maintains a</td>
<td>Review the insurer’s process to accumulate and disclose entities with which a consolidated tax return is filed.</td>
<td>Review the insurer’s allocation methodology for appropriateness and verify the accuracy of the allocation. Verify that tax-related intercompany balances are settled in accordance with written agreements.</td>
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<td>Identified Risk</td>
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<td>written agreement, approved by its board of directors (or committee thereof) that sets forth the manner in which the total combined tax is allocable to each consolidated entity.</td>
<td>Review the written agreement and verify approval by the board of directors (or committee thereof) and the domiciliary state insurance department.</td>
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</table>
Annual Statement Blank Line Items

Listed below are the corresponding Annual Statement line items that are related to the identified risks contained in this exam repository:

Bonds
Stocks (Preferred and Common)
Mortgage Loans on Real Estate
Cash, Cash Equivalents and Short-Term Investments
Derivatives
Other Invested Assets
Securities Lending – Reinvested Collateral Assets

Other Annual Statement line items related to investments, whose risks are less common, have not been included in this examination repository. They include the following:

Real Estate
Aggregate Write-Ins for Invested Assets
Contract Loans
Receivables for Securities
Payable for Securities
Investment Income Due and Accrued (P&C Companies)
Drafts Outstanding
Unearned Investment Income (Life Companies)
Liability for Deposit-Type Contracts (Life Companies)
Miscellaneous Liabilities – Asset Valuation Reserve
Contract Liabilities Not Included Elsewhere – Interest Maintenance Reserve
Contract Liabilities Not Included Elsewhere – Surrender Values on Cancelled Contracts (Life Companies)

Relevant Statements of Statutory Accounting Principles (SSAPs)

All of the relevant SSAPs related to the investment process, regardless of whether or not the corresponding risks are included within this exam repository, are listed below:

No. 2R  Cash, Cash Equivalents, Drafts, and Short-Term Investments
No. 7   Asset Valuation Reserve and Interest Maintenance Reserve
No. 21  Other Admitted Assets
No. 23  Foreign Currency Transactions and Translations
No. 26  Bonds
No. 30  Unaffiliated Common Stock
No. 32  Preferred Stock
No. 34  Investment Income Due and Accrued
No. 37  Mortgage Loans
No. 38  Acquisition, Development and Construction Arrangements
No. 39  Reverse Mortgages
No. 40R Real Estate Investments
No. 41R Surplus Notes
No. 43R Loan-Backed and Structured Securities – Revised
No. 44  Capitalization of Interest
No. 48  Joint Ventures, Partnerships and Limited Liability Companies
No. 49  Policy Loans
No. 56  Separate Accounts
No. 74  Insurance-Linked Securities Issued Through a Protected Cell
No. 83  Mezzanine Real Estate Loans
No. 86  Derivatives
No. 90  Impairment or Disposal of Real Estate Investments
No. 93  Low Income Housing Tax Credit Property Investments
No. 97  Investments in Subsidiary, Controlled and Affiliated Entities
No. 103R  Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

**NOTE:** Due to the length of the Investments Repository, only pages with proposed revisions are shown.
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<th>Identified Risk</th>
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| The insurer may not effectively manage its asset duration to match its future liabilities. | LQ ST | Other | AIPS | The insurer has a process in place in which assets and liabilities are reviewed to ensure the insurer has enough assets to convert to cash to pay obligations. This should include consideration of call, extension and deferral (i.e., duration) of the assets, liquidity and market value volatility. | Obtain documentation to evidence the insurer is reviewing the matching of assets and liabilities and test for effectiveness as follows:  
• Verify the insurer has a process in place to determine the expected liability durations and to check the impact of any asset/liability mismatch.  
• Review maximum asset/liability mismatch duration allowed for reasonableness.  
• Verify asset data used for compliance of policy.  
• Verify that the duration mismatches are not allowed to go outside of set parameters. | Test assumptions used in the asset and liability matching analysis. Determine whether the assumptions are reasonable based on overall economic and company historical and trend data and validate that the company’s illiquid assets (including private placement, hedge fund, real estate, special deposits/restricted assets and affiliate investments) were all considered in its analysis. |
<p>| | | | | Actuaries document for investment staff the duration of the liabilities through economic scenario testing. The company has a process in place to adjust its investment strategy to match the documented duration. | Ensure that the company considers call, extension and deferral risk in its duration planning. | Verify underlying data used to analyze the matching of assets and liabilities using the pricing documents showing liability durations, and the Actuarial Opinion Memorandum showing asset and liability cash flows. |
| | | | | The insurer has a governance structure that routinely challenges, approves and reviews the asset/liability matching activities of the insurer. | Obtain documentation of the governance and verify adequacy of reviews performed by management. | If necessary, utilize an investment specialist and/or actuary to analyze the insurer’s asset/liability matching. |
| | | | | The actuaries and investment staff meet regularly (e.g., monthly) to review asset and liability | Obtain documentation of the interaction between the investment staff and actuaries to ensure its | Review asset and liability cash flows to determine how hedging impacted asset liability matching. Trace material mismatches to appropriate communication. |</p>
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<td>The insurer does not review its liquidity position to determine if adjustments are necessary to meet its potential near-term cash flow needs.</td>
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<td>cash flows. Meetings discuss any large asset or liability cash flows expected, the durations of the in-force assets and liabilities, and the expected duration of new liabilities and asset purchases. Material hedge mismatches are investigated and remediated.</td>
<td>thorough and timely considering the size and complexity of the company’s portfolio. In addition, verify that identified mismatches are appropriately remediated by the company.</td>
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<td><strong>Please Note:</strong> Examiners may wish to refer to the Exam Planning Questionnaire section on liquidity (Exhibit B, Section K) to assist in identifying and assessing potential risk in this area.</td>
<td>OP ST LQ</td>
<td>Other</td>
<td>LC</td>
<td>The insurer has liquidity measurement, monitoring and management framework which includes a written liquidity plan with contingency and stress-testing features.</td>
<td>Determine whether management’s review of the liquidity plan and stress testing procedures and assumptions is reasonable considering its experience and market history.</td>
<td>Validate that the company’s illiquid assets (including private placement, hedge fund, real estate, special deposits/restricted assets and affiliate investments) were all considered and determine whether it relies heavily upon non-traditional or non-insurance activities (e.g., commercial paper and securities lending) for liquidity. Validate company liquidity testing to confirm results under stressed scenarios. If necessary, utilize an investment specialist and/or actuary to analyze the insurer’s liquidity position.</td>
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**Financial Reporting Risks**

| The insurer’s bonds, stocks and short-term investments that are considered hard-to-value, high-risk and/or | MK | VA | VIIA | The insurer reconciles its investments to the statements received from its investment managers/custodians on a | Inspect reconciliations of the insurer’s recorded investments to the investment statements received from investment | Review Jumpstart investment exception reports to determine whether the company’s quality assurance controls |
D. Related Party/Holding Company Considerations

As insurance holding companies grow in complexity, related parties often represent a significant area of risk for insurance companies under exam. Risks may arise from transactions and agreements arising from relationships with affiliates that affect the insurer’s ongoing solvency position. Risks may also originate from inequitable contract provisions, the impact of guarantees, contagion risks extending from holding company operations, intercompany tax issues, etc. Consistent with other complex areas of an exam, it is important that the examiner leverage analyst insights when deciding upon group risks that have a potential solvency impact on the legal entity under exam. As the examination process is generally legal-entity focused, the exam team should limit its review of group issues to those with the potential to significantly impact the solvency position of the insurer(s) under examination. The narrative that follows will help examiners understand the risks that related parties may pose insurance companies both in relation risks that originate from transactions as well as risks that stem from the relationship between the related party entities.

General Related Party Considerations

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

Potential abuses:

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

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

3. Other forms of misrepresentation:
   - Creating nonexistent receivables due from affiliates for “window-dressing” purposes during examination or at the financial statement date.
   - Assuming the liabilities by/for an affiliate.

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

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

**Related Party Transactions**

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

- Transactions having implications as to potentially misleading the presentation of the Annual Statement. Such transactions frequently have involved questionable dealings, including management fraud. This type of affiliated-related party transaction occurs infrequently, but constitutes a difficult area.

- Transactions occurring in the ordinary course of business are considered affiliated-related party transactions only because of an existing relationship between the transacting parties.

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

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

1. A parent company and its subsidiaries.
2. Subsidiaries of a common parent.
3. The reporting entity and:
   - Other affiliated businesses.
   - Management (including directors).
- Principal owners.
- Pension and profit-sharing trusts managed by or under the trusteeship of management.
- Entities for which investments are accounted for by the equity method.

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

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

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 related party transaction exists. Where subtle affiliated relationships are known or believed to exist, examiners should perform procedures to determine whether an affiliated transaction related party transaction classification is appropriate. Although oral representations of management or others often are required to understand the business purpose of the transaction, such representations should be evaluated in light of apparent motives and the weight of other evidence. Important oral representations should be confirmed in writing, either in the letter of representations or in a separate letter.

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

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

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

Circumstances such as these should increase the examiner’s skepticism of management. These circumstances might illustrate a management team determined to attain its objectives, regardless of the means required to do so.
If the transaction is recurring, there should be a contract/agreement in place and it is required to be filed with the department under the NAIC’s Insurance Holding Company System Model Regulation (§450). Additional insight, including provisions the regulator can consider are included in Section I-III (F) Outsourcing of Critical Functions, under the “Affiliated Service Providers” heading.

Affiliated Transaction/Related party Transactions with Partial or No Accounting Recognition

Transactions by or among affiliates are considered to be related party transactions 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/related party transaction.

Affiliates/Related Parties 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 usually is acceptable to obtain written representation from appropriate management and the affiliate that significant influence was not exercised, provided that by reference to the entity’s minutes or otherwise, the examiners are able to satisfy themselves that the affiliate’s vote did not influence the outcome of the board’s decision (e.g., the resolution was unanimously approved). If examiners are unable to satisfy themselves as to the absence of significant influence, or if they otherwise 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.

Certain procedures that usually are performed to achieve other examination objectives also are used in identifying affiliated 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.

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.
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To: Susan Bernard, Chair, Financial Examiners Handbook (E) Technical Group  
From: Mike Boerner, Chair, PBR Review (EX) Working Group  
Re: Financial Condition Examiners Handbook – Principle-Based Reserving Guidance

In 2016, the PBR Review Procedures (EX) Subgroup received the following charge:

The subgroup will provide recommendations to the working group for changes to the examiners handbook and the financial analysis handbook and provide recommendations to carry out other subgroup charges.

In response to this charge, the Subgroup has worked with NAIC Exam and Actuarial staff to identify revisions to the Financial Condition Examiners Handbook (Handbook) to help regulators address Principle-Based Reserving (PBR) related risks during the course of a risk-focused examination. The Subgroup has developed the following recommended updates to the Handbook guidance:

Section 1 – 3: Revisions proposed would highlight situations in which regulators should consider the use of an actuarial specialist to assist in addressing PBR related risks.

Section 1 – 6: The Subgroup proposes adding a new section to the Handbook guidance to provide regulators with background on Life Insurance Reserves.

Reserves/Claims Handling (Life) Repository: The Subgroup drafted new risks and updated existing risks to assist examiners in identifying the most common risks associated with PBR. The subgroup also developed suggested updates to the controls, tests of controls, and tests of details, as appropriate.

Exhibit M: The Subgroup drafted updates to the Exhibit M guidance to assist regulators in assessing if the insurer’s corporate governance structure provides appropriate oversight for PBR related activities.

Exhibit Y: The Subgroup drafted several additional questions that regulators may consider as they perform interviews during the planning phase of the exam.

As part of the Subgroup’s work, the Subgroup discussed the Handbook’s use of the term “credentialed” when referring to the involvement of an actuarial specialist. The Subgroup felt that in the context in which the term is used, the term “qualified” might be a better expectation for regulators to consider in specialist selection. The use of the term qualified would help to ensure regulators use appropriate staffing for review of an inherently complicated area of an exam, as not all credentialed actuaries are expected to possess the requisite knowledge and experience in this area. However, as this term is widely used beyond the Examiners Handbook (see Analysis & Accreditation Handbooks), the Subgroup asks that the Handbook Technical Group study the issue further and determine if a wording change is needed.

Please contact Larry Brunning (lbrunning@naic.org) or Jim Stinson (jstinson@naic.org), NAIC Staff for the PBR Review Procedures (EX) Subgroup, with any questions you may have.

cc: Bruce Jenson, Bailey Henning, Miguel Romero

Attachment (Exam Handbook Draft Revisions)
III. GENERAL EXAMINATION CONSIDERATIONS

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

A. General Information Technology Review
B. Materiality
C. Examination Sampling
D. Business Continuity
E. Using the Work of a Specialist
F. Outsourcing of Critical Functions
G. Use of Independent Contractors on Multi-State Examinations
H. Comments and Grievance Procedures Regarding Compliance with Examination Standards

--------------------------------------------Detail Eliminated to Conserve Space--------------------------------------------

E. Using the Work of a Specialist

1. Decision to Use the Work of a Specialist

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

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

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

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

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

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

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

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

b. Property & Casualty company examinations where the company has a substantial amount of long-tail lines of business require the involvement of a credentialed actuary to perform an evaluation of loss reserves.
In all other situations, the decision to use a specialist is at the discretion of the examination team in consultation with the chief examiner or designee.

2. Selecting a Specialist

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

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

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

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

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

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

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

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

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

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

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

4. Documentation of Work Performed by the Specialist

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

5. Review and Use of the Findings of the Specialist

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

6. Additional Considerations for Commonly Used Specialists

**IT Specialist**

The use of an IT specialist in performing an IT Review should be considered for all multi-state examinations. However, examinations of less-complex IT systems or systems where extensive test documentation is already available (e.g., external audit work, SSAE 16 reports, etc.) may minimize the need to involve an IT specialist. When selecting IT specialists, the examination team should keep in mind designations indicating that specialists have met specific training and educational requirements, such as CISA, AES, CITP, CRISC, etc. For more guidance on the use of an IT specialist during an examination, see Section 1 Part III A on General Information Technology Review.

**Reinsurance Specialist**

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

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

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

**Actuarial Specialist**

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

Investment Specialist

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

- The insurer maintains a significant position greater than its competitors’ averages in any of the following investment categories:
  - Bonds with call options and varied payment timing
  - Foreign investments
  - Hybrid capital securities
  - Mezzanine loans
  - Affiliated investments
  - RMBS, CMBS, ABS CO/CLO or similar bond collateral types
  - Structured securities on negative watch
- The insurer participates in derivative trading;
- The insurer participates in securities lending, repurchase and reverse repurchase transactions; and
- The insurer has significant exposure to liquidity and asset/liability matching risks.

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

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

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

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

A. Life Insurance Reserve Overview
B. Formula Based Valuation Methodology
C. Principle-Based Valuation Methodology
D. Actuarial Opinion and Asset Adequacy Analysis
E. Actuarial Oversight and Internal Controls

A. Life Insurance Reserve Overview

Life insurance reserves represent the liability established by the insurance company to pay future policy benefits such as death benefits upon the death of the insured, endowment benefits upon the maturity of a life insurance policy and cash surrender benefits upon the surrender of the life insurance policy. Historically, the company liability to pay future policy benefits has been determined by calculating a reserve based on a formula valuation methodology as described below. Life insurance products have evolved over time and today, such products may be quite complex offering multiple benefits and/or options to the policyowner or the insured or both the policyowner and the insured within a single contract such as death benefits, accelerated death benefits, secondary guarantees such as no lapse guarantees, policy loans, retirement income benefits such as guaranteed lifetime income benefits and long term care benefits. The value of some of these complex benefits depends upon the current and future market value of the underlying assets. Regulators have found it increasingly difficult to define or modify a formula based valuation methodology to value all the options and/or benefits in a single contract. This complexity of current insurance products along with the fact that the value of certain benefits depends upon the current and future market value of underlying assets has led to the development of a principle-based valuation methodology which incorporates the value of both asset and liability cash flows. The principle-based valuation methodology is described below.

In order to implement the principle-based valuation methodology, amendments to the Standard Valuation Law were adopted in 2009 and a Valuation Manual was developed. The Valuation Manual which is referred to in the amended Standard Valuation Law provides reserve requirements for life, health, and annuity products issued on and after the manual’s operative date. Requirements include all of the details of the methodology for determining a principle-based reserve as well as any changes to the formula based valuation methodology that occurs on and after the operative date of the Valuation Manual. The operative date of the Valuation Manual is January 1, 2017. Unless a change in the Valuation Manual specifies a later effective date, changes to the Valuation Manual shall be effective January 1 following the date when the change to the Valuation Manual has been adopted by the NAIC by an affirmative vote of at least three-fourths (3/4) of the members of the NAIC voting but not less than a majority of the total membership and such members voting in the affirmative represent jurisdictions totaling greater than 75% of the direct premiums written as reported in the most recent life, accident and health annual statements, health annual statements, or fraternal annual statements. No state legislative adoption is needed to effect changes to the Valuation Manual.

The Valuation Manual defines the insurance contracts that are subject to a principle-based valuation (Section II). Unless otherwise specified in Section II of the Valuation Manual, the principle-based valuation methodology will apply to life insurance contracts issued on or after the operative date of the Valuation Manual, however a company may elect to defer the implementation of the principle-based valuation methodology to life insurance contracts issued during the first 3 years following the operative date of the Valuation Manual. Since elements of the Actuarial Method in AG 48 are based on VM-20, a company may “partially implement” the Valuation Manual during the deferral period even though for new business the company otherwise defers implementation.

Actuarial Guideline 48 (AG 48) was adopted December 16, 2014 with an effective date of January 1, 2015 and refers to the Actuarial Method which is also a principle based methodology that companies may use in evaluating level of primary assets held by captive insurers in support of reserves. If regulators determine that the insurer under examination has business subject to AG 48, they may also consider the involvement of a credentialed actuary and may apply the concepts discussed in evaluating PBR.
A Valuation Analysis Working Group (VAWG) consisting of regulators with expertise in actuarial, financial analysis and examination experience reports to the Financial Condition (E) Committee and supports the states in the review of Principle-Based Reserves (PBR) to ensure consistent implementation and application of the methodology. VAWG will also suggest necessary changes to the Valuation Manual to enhance clarification and interpretation of application of the principle-based valuation methodology.

In addition, NAIC actuarial staff is available to provide expertise in modeling insurance cash flows to assist individual states and VAWG in conducting analyses and examinations to verify the PBR and exclusion test calculations performed by the company.

Due to the complexities of life insurance products, the involvement of a credentialed actuary is required on all examinations of life and health insurers with a substantial amount of interest-sensitive business or with a substantial amount of PBR calculations or subject to PBR exclusion tests See Section 1, Part III, E. Using the Work of a Specialist for further reference.

**B. Formula Based Valuation Methodology**

Theoretically, the formula based reserves represent the present value of future guaranteed benefits reduced by the present value of expected future net premiums. The insurance policy is a unilateral contract whereby the insured can cancel the agreement to pay premiums at any time. However, the insurer is “locked in” regardless of future experience and cannot forfeit on its guarantees as long as the premiums are paid. Life reserves are required in order to ensure that commitments made to policyholders and their beneficiaries will be met, even though the obligations may not be due for many years. Since the primary purpose of life reserves is to pay claims when they become due, life reserves must be adequate and the funds must be safely invested.

The Valuation Manual prescribes the minimum standards to be used in determining the formula based reserves as applicable in addition to principle-based reserves as discussed elsewhere in this document. Currently for most formula based reserves, the manual refers to requirements in the NAIC Accounting Practices and Procedures Manual (AP&P Manual). Insurers may establish life reserves, which equal or exceed these minimum standards. These minimum life reserve standards specify a: 1) valuation mortality table; 2) maximum valuation rate of interest; and 3) valuation method. The valuation method used to define minimum life reserves for statutory accounting purposes is referred to as the Commissioners Reserve Valuation Method (CRVM). The mortality rate assumptions are substantially higher than what the insurer can expect to realize from medically underwritten insurance policies. The interest rate assumptions are intended to be significantly lower than current money and capital market yields. Thus, the life reserves developed are generally conservative.

There are three general valuation methods under a formula based valuation methodology used to value life reserves. The net level premium method does not provide for a first-year acquisition cost allowance in determining life reserves. Therefore, this method results in the most conservative, or highest, life reserve valuation of the three methods. The full preliminary term method does provide a first-year expense allowance and then assumes that the remaining premium stream is used to cover policy benefits. The Commissioners Reserve Valuation Method (CRVM) is a form of the full preliminary method. This method allows for a lower life reserve valuation than the net level premium method in the earlier years of the policy term. The modified preliminary term method is a variation of the two methods described above and results in a reserve valuation between the net level premium and preliminary term methods.

As described below, the type of life insurance policy dictates the amount of the life reserve that must be established and the duration for maintaining the reserve. In addition, special situations arise which require unique reserving techniques. The following summarizes the major types of life insurance policies, and the related reserving implications under a formula based valuation methodology:

1. **Ordinary Life Reserves**

   Under a whole life plan of insurance, the insurer is obligated to maintain a reserve until the death of the insured. Term life insurance provides coverage only for the period that is specified in the policy. Under a term insurance plan, the insurer must maintain a reserve, which reduces to zero upon expiration of the term period. Similar to
term insurance, endowment life insurance provides coverage for a period specified in the policies. Unlike term insurance, the proceeds of endowment insurance are payable if the insured lives to the end of the period. Policies, which permit flexible premium payments, are referred to as “universal life” policies and those with fixed premiums are referred to as “interest sensitive” policies. Universal life policies are accumulation type policies where the current account value is determined based upon the accumulation of premiums less mortality charges and expense charges, plus a current interest rate credit. The account value less surrender charges is the cash value. Because of the unique features of universal life and interest sensitive types of policies, unique reserving requirements are specified for them in Appendix A-585, Universal Life Insurance, of the AP&I Manual. The minimum standard for universal life reserves consider guarantees within the policy at the time of issue, present value of future guaranteed benefits, account value and cash value.

2. Group Life Reserves
Most group life insurance is monthly renewable term insurance. For these policies, gross premiums are typically recalculated periodically, most often annually, using the age and sex census of the group along with experience adjustments. Therefore, the reserve is usually calculated as the unearned premiums or a percentage thereof to estimate the claim exposure. However, some group life insurance policies provide permanent or longer term benefits analogous to individual coverages. In these cases, the reserving methods are similar to those employed for individual insurance, using appropriate mortality tables. Appendix A-820 does not specify a mortality table for group life insurance but leaves that to the discretion and approval of the domiciliary state.

3. Industrial Life Reserves
Industrial life insurance is unique in that it involves higher unit premiums, smaller face amount policies and higher mortality expectations. The minimum standards for reserves are the same as the traditional life insurance except that a unique mortality table is used.

4. Credit Life Reserves
Credit life insurance policies are designed to discharge a debt upon the debtor’s death. They are usually funded as a single premium. Reserve requirements vary among the states. Key considerations include claims reserves and policy reserves based on a state-specified combination of mortality reserves, unearned premium reserves, and potential refunds. Credit Life and Disability Reserves are addressed in Valuation Manual (VM)-26

4.5 Life Reserves Relating to Riders
Life insurance policies frequently include riders for additional benefits such as accidental death and disability and waiver of premium upon disability. The minimum valuation standards for reserves are the same as for the base life insurance except that specialized mortality and disability tables are used and the net level premium valuation method is required.

5. Miscellaneous Life Reserves
There are various other special situations involving life reserves. First, a deficiency reserve may be required in situations where the actual policy gross premium is less than the valuation net level premium. This situation occurs when pricing assumptions are used that are different from the minimum reserve valuation standards. This does not necessarily indicate that the policy is being sold at a loss by the insurer, but rather is a reflection of the highly conservative nature of the minimum reserve valuation standards. Second, there may be unusual situations where the cash surrender value of a life insurance policy is greater than the minimum reserve standard. In these situations, life reserves must be increased by the amount of this excess.

6. Minimum Aggregate Reserves
In the aggregate, policy reserves for all life insurance policies valued under a formula based valuation methodology that are reported in the statutory financial statements must equal or exceed reserves calculated by using the assumption and methods that produce the minimum formula standard valuation.
C. Principle-Based Valuation Methodology

In general, under a principle-based valuation methodology, all of the liability cash flows emanating from the contract benefits provided in the product are determined for each period and compared with all of the asset cash flows for each period determined from the assets the insurance company has purchased or plans to purchase or sell to fund the liability cash flows. The resulting differences between the asset and liability cash flows for each period are valued under a range of likely or plausible economic scenarios. Economic scenarios may consist of interest rates or market returns or both depending on the nature of the asset and liability cash flows. A single economic scenario represents multiple consecutive periods (such as 30 or 40 years) of movements in the underlying interest rate or market rate returns. The length of the scenario period is determined by the length of the liabilities being valued. The economic scenarios are stochastically (randomly) generated using a prescribed Economic Scenario Generator (ESG). The prescribed ESG can be found on the Society of Actuaries website.

The principle-based valuation methodology developed for life insurance contracts defines 3 components of a principle-based reserve: 1) a net premium reserve (NPR); 2) a deterministic reserve (DR); and 3) a stochastic reserve (SR). The level of risk embedded in a life insurance contract will determine whether the principle-based reserve will consist of all 3 reserve components (NPR, DR, SR), or only 2 reserve components (NPR, DR); or only 1 reserve component (NPR). The principle-based valuation methodology defines a stochastic exclusion test and a deterministic exclusion test each of which are designed to measure the level of risk embedded in a life insurance contract. Life insurance contracts that pass an exclusion test are then exempt from the calculation of the associated principle-based reserve component. For example, all life insurance contracts that pass the stochastic exclusion test but fail the deterministic exclusion test, must calculate the NPR and DR components. Life insurance contracts that pass both the stochastic and deterministic exclusion tests need only calculate the NPR component. For groups of policies other than variable life or universal life with a secondary guarantee, a company may provide a certification by a qualified actuary that the group of policies is not subject to material interest rate risk or asset return volatility risk in lieu of performing the stochastic exclusion ratio test or stochastic exclusion demonstration test. In addition, a company is not required to compute stochastic reserves and deterministic reserves on any of its ordinary life policies if it meets the conditions of Section 2 of VM-20 referred to as the “companywide exemption”. If the domestic commissioner does not reject a company’s application for the companywide exemption pursuant to Section 6 of VM-20, then the company will compute reserves for its ordinary life policies per the requirements provided in VM-A and VM-C of the Valuation Manual.

The reserve stochastic resiliency is determined as a function of the discounted value of the differences between the asset and liability cash flows for each period over the range of economic scenarios. Economic scenarios may consist of interest rates or market returns or both depending on the nature of the asset and liability cash flows. A single economic scenario represents multiple consecutive periods (such as 30 or 40 years) of movements in the underlying interest rate or market rate returns. The length of the scenario period is determined by the length of the liabilities being valued. The economic scenarios are stochastically (randomly) generated using a prescribed Economic Scenario Generator (ESG). The prescribed ESG can be found on the Society of Actuaries website. The objective is to determine if there is a reasonable likelihood that assets are insufficient to cover the obligations of the company, and by what amount they may be insufficient. Under economic scenarios where assets are insufficient, the principle-based methodology determines all the amounts of the insufficiencies and discounts them back to the valuation date. The largest discounted value is known as the Greatest Present Value of Accumulated Deficiencies, or “GPVAD”, for that scenario. The stochastic reserves may be set at a CTE(70) level (conditional tail expectation at the 70% level). The function CTE(70) means the average of the 30% (100% - 70%) worst (largest) GPVADs. So for example if a company randomly generates 1,000 economic scenarios, it would then determine the largest accumulated amount of deficiency for each of the 1,000 scenarios. The CTE(70) stochastic reserve level would be determined by taking the average of the 300 [1,000 x (100% - 70%)] worst GPVADs out of the 1,000 scenarios.
exclusion test are then exempt from the calculation of the associated principle-based reserve component. For example, all life insurance contracts that pass the stochastic exclusion test but fail the deterministic exclusion test, must calculate the NPR and DR components. Life insurance contracts that pass both the stochastic and deterministic exclusion tests need only calculate the NPR component. For groups of policies other than variable life or universal life with a secondary guarantee, a company may provide a certification by a qualified actuary that the group of policies is not subject to material interest rate risk or asset return volatility risk in lieu of performing the stochastic exclusion ratio test or stochastic exclusion demonstration test. In addition, a company is not required to compute stochastic reserves and deterministic reserves on any of its ordinary life policies if it meets the conditions of Section 2 of VM-20 referred to as the “companywide exemption”. If the domestic commissioner does not reject a company’s application for the companywide exemption pursuant to Section 4 of VM-20, then the company will compute reserves for its ordinary life policies per the requirements provided in VM-A and VM-C of the Valuation Manual.

Note that some states incorporated a “companywide exemption” in the Standard Valuation Law that may override Section 2 of VM-20. In such cases the state’s Standard Valuation Law will determine whether a company is not subject to computing the stochastic and deterministic reserves. Note also, the commissioner may exempt specific product forms or product lines of a domestic company that is licensed and doing business only in a single state as defined in Section 15 of the amended NAIC Model Standard Valuation Law.

As part of the calculation process, the principle-based valuation methodology allows companies to aggregate or group policies with similar risk characteristics. For example, all term policies that provide only a death benefit and do not provide any cash surrender values may be grouped together by underwriting class. The exclusion tests are then applied on a group or aggregated basis and not a contract by contract basis. Also, the DR and the SR are calculated on the aggregated or group basis. However, the SR must be performed using aggregation subgroups that do not intermingle multiple product groups (Term, ULG, Other). The NPR component is a fully prescribed formula based reserve and must be applied on a contract by contract basis.

The annual statement blank contains a VM-20 Supplement. This supplement breaks out the principle-based reserve into its various components of NPR, DR and SR. Regulators may request the assistance of NAIC modeling staff and or VAWG in verifying exclusion testing as well as various components of the principle-based reserve on a smaller sample set of company contracts.

D. Actuarial Opinion and Asset Adequacy Analysis

Due to the complexity in determining life reserves, insurers must rely on actuaries to assist with valuation of these reserves. Insurers are required to annually obtain an opinion regarding the reasonableness of the reserves by a qualified actuary who is appointed by the company. The actuarial opinion requirements are provided in VM-30 of the Valuation Manual. These requirements also include requirements for asset adequacy analysis. As a result of the asset adequacy analysis conducted by the appointed actuary, the actuary may conclude that the insurer’s assets are not adequate to cover future liabilities as valued by the calculated reserves. When this occurs, reserves must be increased by the estimated deficiency resulting from asset adequacy testing.

E. Actuarial Oversight and Internal Controls

Appendix G of the Valuation Manual provides guidance that while not expanding the existing legal duties of a company’s board of directors, senior management, and appointed actuary and/or qualified actuaries, provides guidance that focuses on their roles in the context of principle-based reserves. A summary of the duties and expectations for the board of directors and senior management is provided as follows below. If an actuarial specialist is involved in an examination, Appendix G includes additional requirements that should be considered during the review of the company’s actuarial oversight and associated internal controls.

1. The Board of Directors should:
   a. Receive and reviews reports, including the certification of the effectiveness of internal controls with respect to the principle-based calculation, as provided in Section 12.B.(2) of the Standard Valuation Law.
b. Understand the process undertaken by senior management to correct any material weaknesses in the internal controls with respect to a principle-based reserve valuation, if any is identified.

c. Understand the infrastructure (consisting of policies, procedures, controls and resources) in place to implement and oversee principle-based reserve processes.

d. Ensure the proper documentation of review and action undertaken by the board relating to the principle-based reserving function in the minutes of all of the board meetings where such function is discussed.

2. Senior Management should:

a. Ensure that an adequate infrastructure (consisting of the risk tolerances, policies, procedures, controls, risk management strategies and resources) has been established to implement the principle-based reserving function.

b. Review for reasonableness the principle-based reserving elements (consisting of the assumptions, methods and models used to determine principle-based reserves of the insurer company or group of insurance companies) that have been put in place.

c. Review the principle-based reserving results for consistency with established risk tolerances of the insurance company or group of insurance companies in relation to the risks of the products of the insurance company or group of insurance companies offers, the various strategies used to mitigate such risks, and its emerging experience, in order to understand the general level of conservatism incorporated into principle-based reserves.

d. Review and address any significant and/or unusual findings in light of the results of the principle-based reserve valuation processes and applicable sensitivity tests of the insurance company or group of insurance companies.

As examiners perform both the Corporate Governance assessment and the examination interviews, the topics above should be considered to ensure that the companies with transactions governed by PBR are adequately implementing the relevant portions of the Valuation Manual.

Additional procedures regarding the examiners’ assessment of the insurer’s PBR related risks, controls, and possible test procedures can be located in Section 3 Reserves/Claims Handling (Life) repository.
Annual Statement Blank Line Items

Listed below are the corresponding Annual Statement line items that are related to the identified risks contained in this exam repository:

Aggregate Reserve for Life Contracts
Aggregate Reserve for Accident and Health Contracts
Liability for Deposit-Type Contracts
Contract Claims

Relevant Statements of Statutory Accounting Principles (SSAPs)

All of the relevant SSAPs related to the life insurance reserving process, regardless of whether or not the corresponding risks are included within this exam repository, are listed below:

No. 5R Liabilities, Contingencies and Impairments of Assets – Revised
No. 50 Classifications of Insurance or Managed Care Contracts
No. 51 Life Contracts
No. 54 Individual and Group Accident and Health Contracts
No. 55 Unpaid Claims, Losses and Loss Adjustment Expenses
No. 61R Life, Deposit-Type and Accident and Health Reinsurance – Revised
No. 63 Underwriting Pools
No. 70 Allocation of Expenses
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<tr>
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<tr>
<td><strong>Other Than Financial Reporting Risk</strong></td>
<td>ST</td>
<td>Other</td>
<td>RA</td>
<td>The insurer’s board of directors (or committee thereof) has adopted and/or reviewed the insurer’s overall reserving practices. The board of directors (or committee thereof) regularly discusses reserving issues and receives reports from the appointed actuary. The reports include an explanation of the reserving policy and methodology, as well as an analytical review of the insurer’s reserves. The insurer monitors and revises its reserving practices as needed.</td>
<td>Verify that the insurer has established overall reserving practices that have been adopted and/or reviewed by the board of directors (or committee thereof). Review board of directors (or committee thereof) minutes to ensure regular discussion of reserving issues including reports (at least annually) from the appointed actuary. Obtain information on revisions made by the insurer to its reserving practices and verify the revisions were appropriately reviewed and/or approved by the board of directors (or committee thereof).</td>
<td>Obtain information on the insurer’s overall reserving practices and forward it to the insurance department actuary or an independent actuary for review. Discuss with members of the board of directors (or committee thereof) their level of involvement in monitoring the implementation of reserving practices.</td>
</tr>
<tr>
<td>The insurer has not taken appropriate steps to prepare for the implementation of principle-based Reserving (PBR). Note: Under the requirements of the Valuation Manual, companies have until</td>
<td>RV</td>
<td>Other</td>
<td>RA</td>
<td>The insurer has a PBR implementation plan that includes consideration of staffing needs and appropriate expertise in current and/or future budgets and strategic plans.</td>
<td>Verify that budgets and/or strategic plans contain consideration of PBR implementation needs including qualified staff. Determine if the company has adequate suitability requirements in place for the actuarial department that requires the actuarial staff to be qualified to implement.</td>
<td>Review the insurer’s PBR implementation plan for reasonableness. Review actuarial department staff qualifications to determine if suitability requirements are met and/or determine if actuarial staff has adequate training available for implementation of PBR.</td>
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<td>1/1/2020 to implement PBR requirements. See Section 1-6 for further information on the implementation of PBR.</td>
<td></td>
<td></td>
<td></td>
<td>The insurer has a process to monitor the progress and ongoing needs of PBR implementation.</td>
<td>and practice a PBR methodology. Review the insurer’s procedures to determine if pending PBR implementation needs are continuously monitored by company personnel.</td>
<td>Consider involving an IT specialist in a review of system capabilities necessary for PBR implementation.</td>
</tr>
<tr>
<td>Financial Reporting Risks</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td>Data reporting and system needs are reviewed by management on a periodic basis in preparation for PBR implementation.</td>
<td></td>
</tr>
<tr>
<td>In-force data utilized by the actuary to calculate reserves for life, A&amp;H and deposit-type contracts is not complete or accurate nor consistent with accounting records.</td>
<td>OP RV</td>
<td>CO AC</td>
<td>RD</td>
<td>The insurer established appropriate internal controls over the input and maintenance of in-force data as outlined in the Examination Repository – Underwriting.</td>
<td>Perform tests to verify the operating effectiveness of policy in-force controls as outlined in the Examination Repository – Underwriting. Review the QA reports relating to the testing of in-force data to verify the operating effectiveness of the controls. Verify through observation and/or reperformance that system parameters prohibit the issuance of non-sequential policy numbers. Ensure management review of exceptions.</td>
<td>Obtain a copy of the listing detailing in-force insurance contracts provided to the insurer’s actuary. Perform procedures to verify the completeness of this listing by tracing to the database a sample of contracts selected from sources outside the reserve system (e.g., premium cash collections). Use control totals for face amount, benefits, and policy count in order to detect use of incorrect files.* In conjunction with the testing performed in the Examination Underwriting Repository, select a sample of in-force insurance contracts to verify that the system data reflects the accuracy of the listing.</td>
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</table>
| The data utilized in the company’s PBR model is not representative and consistent with the company’s in-force data. | OP RV AC CO | RD | The insurer maintains a model validation process to confirm that model cells represent actual in-force data. | Review documentation associated with the model validation process performed by the company to ensure agreement between the insurer’s model and aggregated in-force data for attributes such as:  
*Average issue age  
*Gender  
*Policy counts  
*Face amounts  
*Fund values  
*Annualized premium | Compare in-force aggregation and statistics for products under scope of PBR to model output reports at period zero for attributes such as:  
*Average issue age  
*Gender distribution  
*Total policy counts  
*Total face amounts  
*Total fund values  
*Total annualized premium | |
<p>| In-force data is not appropriately restricted and protected to maintain accurate and complete data. | OP AC CO | RA | The insurer maintains logical access controls, including password protection and active directories, to properly restrict access to in-force data. | Test the operating effectiveness of logical access controls by reviewing documentation relating to requests for access and by attempting to have unauthorized individuals access the in-force data. | Select a sample of in-force policy data at the examination as of date for accuracy and completeness testing. * | Test a sample of changes made to in-force policies |</p>
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<tr>
<td>Reinsurance is not properly taken into account in accumulating in-force data. (See also Examination Repository – Reinsurance Assuming Insurer.)</td>
<td>RV</td>
<td>AC</td>
<td>CO</td>
<td>RD</td>
<td>The insurer has established procedures to prepare the in-force data for actuarial review in accordance with the insurer’s reinsurance treaties.</td>
<td>Review the insurer’s reconciliation reports of actuarial data to the insurer’s in-force system, reinsurance reports, and accounting records.</td>
</tr>
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</table>

The insurer has appropriately segregated its duties to ensure that individuals with the ability to update in-force data do not have conflicting responsibilities.

The insurer has established policies and procedures for making accurate, timely changes to policies.

The insurer has established a QA process to review changes to policies to ensure compliance with the insurer’s policies and procedures on a sample basis.

Test the operating effectiveness of segregation controls by attempting to have individuals authorized to access in-force data access claims processing or other systems.

Perform a walkthrough to gain an understanding of the insurer’s process to make changes to in-force policies.

Test a sample of changes to policies reviewed by the QA function for proper implementation of the insurer’s policies and procedures.
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<tbody>
<tr>
<td>The insurer does not properly monitor XXX/AXXX reserve development related to its ceded reinsurance transactions.</td>
<td>RV</td>
<td>AC VA</td>
<td>RA</td>
<td>The insurer monitors actual experience on ceded reinsurance relative to the initial or most recent projections and monitors underlying assumptions to evaluate asset adequacy and report any material adverse deviations to management.</td>
<td>Review the insurer’s process to monitor experience on ceded reinsurance transactions and verify that material adverse deviations are reviewed by management.</td>
<td>Determine whether the insurer’s ceded reinsurance transactions are tracking appropriately relative to the initial or most recent projections and underlying assumptions. For example, compare actual deaths under the reinsurance transaction with expected deaths assumed in the reserve under the reinsurance transaction. Consider utilizing an actuarial specialist to assist in this determination.</td>
</tr>
<tr>
<td>The assumptions and methodologies used by the insurer for life, A&amp;H and deposit-type contracts are not accurate or appropriate.</td>
<td>RV</td>
<td>VA AC PD</td>
<td>RA</td>
<td>The insurer uses consistent assumptions and methodologies that have been based on guidelines outlined in the Valuation Manual (VM) and Appendix A and Appendix C of the NAIC Accounting Practices and Procedures Manual (to the extent appropriate), adequately documented, approved by senior management, and in accordance with statutory accounting principles (SAP) and applicable state statutes and/or regulations.</td>
<td>Gain an understanding of the insurer’s assumptions and methodologies and compare with prior periods. Verify that senior management signs off on assumptions and methodologies used by the insurer, including any changes. Verify senior management review of reports from actuaries and that reports include reserve analyses of all major lines of business. Review the credentials, background and responsibilities of the insurer’s actuarial department staff for compliance with Appendix C.</td>
<td>Review assumptions and methodologies for reasonableness, appropriateness, accuracy, and compliance with the Valuation Manual and Appendix A and Appendix C of the NAIC Accounting Practices and Procedures Manual, with assistance from the insurance department actuary or an independent actuary. Compare actual investment, mortality, morbidity, lapse, interest crediting strategy and expense experience to assumptions, by line of business and to prior-period assumptions. Verify whether the assumptions surrounding contract claim liabilities are</td>
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<td>The insurer maintains a fully staffed, well-qualified actuarial department that meets the requirements of Appendix A-820 of the NAIC Accounting Practices and Procedures Manual.</td>
<td></td>
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<td></td>
<td>A-820 of the NAIC Accounting Practices and Procedures Manual.</td>
<td>in accordance with the relevant SSAPs, as well as applicable statutes, regulations, pronouncements and/or bulletins.</td>
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<tr>
<td>Management receives regular reports on claim liabilities (including IBNR) by line or class of business, as well as other key ratios, and reviews unusual fluctuations on a timely basis to review claim liabilities for adequacy.</td>
<td></td>
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<td></td>
<td>If performed in-house, review and test the actuarial peer review process and related sign-offs.</td>
<td>Utilize the insurance department actuary or an independent actuary to perform an independent calculation/estimate of the life reserves and incurred but not reported (IBNR) contract claims liability.</td>
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<td>Verify management review of contract claim liabilities reporting and test the operating effectiveness of procedures in place.</td>
<td>Determine whether the appropriate disclosures have been made in the Notes to the Financial Statements for any changes in reserve methodologies.</td>
<td></td>
</tr>
<tr>
<td>The assumptions used by the insurer to calculate reserves for policies subject to Principle-Based Reserving are not accurate or appropriate.</td>
<td>RV</td>
<td>VA</td>
<td>AC</td>
<td>PD</td>
<td>RA</td>
<td>Utilize a Department actuary, consulting independent actuary or NAIC Actuarial Modeling support staff to review company documentation that provides support for assumptions and Utilize a Department actuary, consulting independent actuary or NAIC Actuarial Modeling support staff to verify and validate that the company has followed the requirements of PBR as</td>
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<td>Review correspondence related to any peer reviews performed for appropriate depth of review.</td>
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<td>Policies with supplemental or accelerated benefits have not been properly separated and reserved for in accordance with SAP.</td>
<td>OP</td>
<td>AC</td>
<td>RA</td>
<td>The insurer has a process in which supplemental and accelerated benefits are properly identified and reserved.</td>
<td>Test the process surrounding the identification and reserving of supplemental and accelerated benefits.</td>
<td></td>
</tr>
<tr>
<td>Policies subject to Principle-Based Reserving are not properly identified or exclusion testing is not appropriately conducted.</td>
<td>RV</td>
<td>VA</td>
<td>RA</td>
<td>Company conducts and reviews exclusion testing in accordance with Valuation Manual instructions.</td>
<td>Review company support and supervisory sign-off for exclusion testing.</td>
<td></td>
</tr>
<tr>
<td>The life, A&amp;H and deposit-type reserve and IBNR contract claim liability computations are not performed correctly or the selected estimates are unreasonable.</td>
<td>OP</td>
<td>AC</td>
<td>VA</td>
<td>The insurer has an established process that is consistent with the method adopted by the NAIC to calculate the life reserves on an annual basis. The insurer maintains a fully staffed, well-qualified actuarial department that meets the requirements of Appendix A-820 of the</td>
<td>Review the process in place (which may include performance of a walkthrough) to estimate the life reserves.</td>
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<td>Senior management uses internal or independent actuaries to conduct reserve analyses of all major lines on an annual basis.</td>
<td>Obtain actuarial reports to verify whether the insurer is using independent or in-house actuaries to perform the reserve calculations on all major lines of business annually and verify senior management review of reports from actuaries.</td>
<td>Verify management review of reserve reporting and test the operating effectiveness of procedures in place.</td>
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<td>The actuarial calculations are subject to a peer review process.</td>
<td>If performed in-house, review and test the actuarial peer review process and related sign-offs.</td>
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<td>The insurer’s board of directors (or committee thereof) receives an annual presentation on the actuarial analysis process.</td>
<td>Review the meeting minutes of the board of directors (or committee thereof) to verify whether a presentation was given on the actuarial calculation process.</td>
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<td>Management receives regular reports on key ratios and reviews unusual fluctuations on a timely basis to review reserves for adequacy.</td>
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<tr>
<td>The methodologies utilized in PBR are not appropriate or the reserve computations are not performed correctly.</td>
<td>OP RV</td>
<td>AC VA</td>
<td>RA</td>
<td>The company has a formal process in place to develop and validate a model for use in PBR. Governance of the actuarial model includes consideration of: • Security Process</td>
<td>Review evidence that the company followed its process in developing and validating its model for use in PBR.</td>
<td>Utilize a Department actuary, consulting independent actuary, or NAIC Actuarial Modeling support staff to review and evaluate results (e.g. compare results of the</td>
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<td>• Software Change Process</td>
<td>background and responsibilities of the insurer’s actuarial department staff in developing and validating the model used in PBR.</td>
<td>standard portfolio, reasonableness in comparison with prior periods, etc., of the insurer’s modeling computations.</td>
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<td>• Parameter Setting Process</td>
<td>Ensure that company peer review process is in place and operating effectively.</td>
<td>Utilize a Department actuary, consulting independent actuary, or NAIC Actuarial Modeling support staff to recalculate reserves on selected policies.</td>
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<td></td>
<td>• Validation Process</td>
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<td>• Oversight of Overall Model Processes</td>
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<td>Model results have undergone peer review and are subject to reasonableness tests, such as:</td>
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<td>• The insurer manually calculates Net Premium Reserve (NPR) on selected policies.</td>
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<td>• The insurer compares reserves per 1000 of face amount with prior periods.</td>
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<td>• The insurer performs sensitivity testing on key non-prescribed assumptions.</td>
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<tr>
<td>The computation of reinsurance credits within life, A&amp;H and deposit-type reserves are not performed</td>
<td>CR RV</td>
<td>AC VA CO RA</td>
<td></td>
<td>The reserving actuary calculates the reserve on a gross basis and determines the net basis by estimating the reinsurance credits and</td>
<td>Test the operating effectiveness of the insurer’s process for reviewing the reserve analysis to determine</td>
<td>Compare the annual financial statement net and gross incurred for consistency with reinsurance treaties in place</td>
</tr>
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<td>correctly. (See also Examination Repository – Reinsurance Ceding Insurer.)</td>
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<td></td>
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<td>applying them to the gross reserve.</td>
<td>whether life reserves have been estimated on a gross basis, including management approval and sign-off.</td>
<td>at the insurer.</td>
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<tr>
<td>The insurer applies reinsurance credits to life reserves by reviewing reinsurance treaties in place at the insurer, as well as historical results.</td>
<td></td>
<td></td>
<td></td>
<td>Test the operating effectiveness of the insurer’s process to estimate reinsurance credits for life reserves, including management approval and sign-off.</td>
<td></td>
<td>Consider the reasonableness of reinsurance credits taken, based on a review of the insurer’s reinsurance program and treaties in place.</td>
</tr>
<tr>
<td>Test the operating effectiveness of the insurer’s process to estimate reinsurance credits for life reserves, including management approval and sign-off.</td>
<td>OP RV</td>
<td>AC RA</td>
<td></td>
<td>Utilize the insurance department actuary or an independent actuary to perform an independent estimation of the reserve adequacy test to determine whether the overall reserve liability is adequate.</td>
<td>Compare the corresponding reserve held by the reinsurer with the credit taken by the insurer and identify all reasons for differences.</td>
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<tr>
<td>The insurer has a process in place whereby reserve computations are adjusted back to the reporting date.</td>
<td>OP RV</td>
<td>AC RA</td>
<td></td>
<td></td>
<td>Utilize the insurance department actuary or an independent actuary to perform an independent estimation of the reserve adequacy test to determine whether the overall reserve liability is adequate.</td>
<td></td>
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<tr>
<td>The insurer has a process in place to ensure that the correct assumptions and methodologies used to estimate the adequacy of the life reserves.</td>
<td>OP RV</td>
<td>VA RA</td>
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<td>Management reviews the asset adequacy test for reasonableness of the</td>
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<tr>
<td>Verify management review of asset adequacy test.</td>
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<td>Management books reserves that are materially different than the actuary’s best estimate.</td>
<td>OP ST LG</td>
<td>VA PD</td>
<td>RA</td>
<td>The insurer has a process in place to ensure that reserves are recorded based on the actuary’s best estimate, or documents an appropriate reason for any deviations.</td>
<td>Review management’s guidelines regarding the recording of actuarially determined reserves. Verify that deviations from the actuary’s best estimate are properly documented, if applicable.</td>
<td>Review the actuarial report, as well as the annual financial statement and other appropriate documentation, to determine whether the insurer has booked the actuary’s best estimate.</td>
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<td>The board of directors (or committee thereof) compares the booked reserves to the amounts included in the actuarial report by receiving a report from the appointed actuary.</td>
<td>Review meeting minutes of the board of directors (or committee thereof) for evidence of a presentation and review of the actuarial report.</td>
<td>Review the documentation supporting a deviation from the actuary’s best estimate for reasonableness, if applicable.</td>
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<td>The insurer’s organizational structure limits the influence that management can have on the appointed actuary.</td>
<td>Interview the appointed actuary during the planning phase of the examination to determine whether the insurer’s organizational structure is appropriate in this area.</td>
<td></td>
</tr>
<tr>
<td>The insurer is not properly accounting for cash surrender value (CSV) on life (including annuities) contracts.</td>
<td>OP LG</td>
<td>OB/OW PD</td>
<td>RA</td>
<td>The insurer has policies in place to ensure the reporting of CSV on life (including annuities) contracts in accordance with SSAP No. 51.</td>
<td>Ensure the policies for the process used to report CSVs on life (including annuities) contracts is periodically reviewed and approved by management.</td>
<td>For a sample of life (including annuities) contracts with cash surrenders, determine whether the CSV is being properly reported.</td>
</tr>
<tr>
<td>Contract claim liabilities are not established or reviewed in accordance with the insurer’s standards and applicable statutory guidelines.</td>
<td>RV CR</td>
<td>AC VA CO</td>
<td>RA</td>
<td>The insurer has a policy for recording contract claim liabilities and actuaries are involved in establishing and reviewing the policy. Contract claim liabilities are recorded in accordance with the insurer’s policy.</td>
<td>Obtain documentation supporting the insurer’s contract claim liability policy to ensure actuary review and policy adequacy.</td>
<td>For a sample of contract claim liabilities, verify that the calculation is in accordance with the insurer’s policy, applicable statutory guidelines, and are calculated on a timely basis.</td>
</tr>
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<td></td>
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<td></td>
<td>For a sample of contract claim liabilities, determine whether contract claim</td>
<td>From the sample selected</td>
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<tr>
<td>Identified Risk</td>
<td>Branded Risk</td>
<td>Exam Asrt.</td>
<td>Critical Risk</td>
<td>Possible Controls</td>
<td>Possible Test of Controls</td>
<td>Possible Detail Tests</td>
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<tr>
<td>The insurer does not maintain an adequate premium deficiency reserve.</td>
<td>RV</td>
<td>VA</td>
<td>RA</td>
<td>applicable statutory guidelines and within a specified time frame.</td>
<td>reviews were performed and documented in accordance with the insurer’s policy and applicable statutory guidelines.</td>
<td>above, identify any claims included on the detail for which the liability recorded is not consistent with the contract terms. Identify claims that appear to have not been paid in a reasonable or fair time frame. Investigate the status of these claims/benefits with the insurer’s management.*</td>
</tr>
<tr>
<td></td>
<td>RQ</td>
<td>CO</td>
<td></td>
<td>Committees evaluate and strategize claim liabilities involving large or unusual loss contract claim determinations and/or settlements.</td>
<td>Obtain minutes and other meeting materials from the meetings of the committee to determine whether the committee provided appropriate oversight.</td>
<td>Verify that the claims/benefits liability is complete and properly recorded at year-end. Obtain a detail of resisted claims and claims closed without payment. Perform procedures to verify the grounds for the resisted claims. For a sample of contract claim liabilities meeting the criteria to go to a loss/benefits committee, determine whether the liabilities were referred to this committee.*</td>
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<tr>
<td></td>
<td>OP</td>
<td>CM</td>
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<th>Identified Risk</th>
<th>Branded Risk</th>
<th>Exam Asrt.</th>
<th>Critical Risk</th>
<th>Possible Controls</th>
<th>Possible Test of Controls</th>
<th>Possible Detail Tests</th>
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<td>calculations.</td>
<td>calculations.</td>
<td>calculation/estimate of the premium deficiency reserves.</td>
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EXHIBIT M
UNDERSTANDING THE CORPORATE GOVERNANCE STRUCTURE

The purpose of this exhibit is to assist the examiner in documenting the understanding and assessment of an insurer’s corporate governance policies and practices. As insurers are expected to demonstrate different corporate governance practices in accordance with the nature and extent of their operations, examiners should not expect the practices of each individual insurer to specifically match the guidance provided in this exhibit. Therefore, the focus of 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 of Insurance (DOI) annually in accordance with the Corporate Governance Annual Disclosure Model Act (#305) and Corporate Governance Annual Disclosure Model Regulation (#306). The CGAD provides a narrative description of the insurer’s or insurance group’s corporate governance framework and structure and may enhance examination efficiencies when leveraged.

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?
5. What is the frequency and timeliness with which meetings are held with chief financial and/or accounting officers, internal auditors and external auditors?

6. Is the information provided to the board of directors or committee members sufficient and timely enough to allow monitoring of management’s objectives and strategies, the entity’s financial position and operating results, and terms of significant agreements?

7. Is there a formal process through which the board of directors or audit committee is apprised of sensitive information, investigations and improper acts (e.g., travel expenses of senior officers, significant litigation, investigations of regulatory agencies, defalcations, embezzlement or misuse of corporate assets, violations of insider trading rules, political payments, illegal payments) sufficiently and in a timely manner?

An active and effective board of directors, or underlying committee, provides an important oversight function. In addition, because of management’s ability to override system controls, the board of directors plays an important role in ensuring effective internal control, setting the “tone at the top” and setting other management standards that may affect the risk analysis for the company’s activities. Key components include:

1. Independence from management such that, when necessary, difficult and probing questions are raised. For example, consider:
   a. Whether the board of directors constructively challenges management’s planned decisions (e.g., strategic initiatives and major transactions) and probes for explanations of past results (e.g., budget variances).
   b. Whether a board of directors that consists solely of an entity’s officers and employees (e.g., a small corporation) questions and scrutinizes activities, presents alternative views and takes appropriate action if necessary.
   c. The leadership structure of the board. Have there been changes during the exam period? Has the company chosen to combine or separate the principal executive officer from the Chairman of the Board? Why or why not?
   d. If there is a lead independent director. What role does that person play in the leadership of the company?
   e. If there are any other arrangements intended to ensure that, when necessary, difficult and probing questions are raised with or considered by management. If so, what are they?

2. The use of board committees, where warranted, by the need for more in-depth or directed attention to particular matters. For example, consider whether:
   a. Board committees exist.
   b. They are sufficient, in subject matter and membership, to deal with important issues adequately.

3. The knowledge, integrity and experience of directors. For example, consider:
   a. Whether directors have sufficient knowledge, applicable industry experience and time to serve effectively.
   b. Whether directors have demonstrated integrity through their business conduct.
      i. A review of biographical data and background checks performed on directors may provide evidence of appropriate background, integrity and experience from the company licensing process, *Insurance Holding Company System Regulatory Act* (#440) filings, SEC filings, exam planning questionnaires, additional information gathered as a result of the risk-focused surveillance framework, etc.
   c. Changes in board composition during the examination period, including those that have broadened the experience of the directors as a whole.
   d. The criteria for identifying board of director candidates.

4. The frequency and timeliness with which meetings are held with chief financial and/or accounting officers, internal auditors and external auditors. For example, consider whether:
   a. The audit committee meets privately with the chief accounting officer and internal and external auditors to discuss the reasonableness of the financial reporting process, system of internal control, significant comments and recommendations, and management’s performance.
   b. The audit committee reviews the scope of activities of the internal and external auditors annually.
5. The sufficiency and timeliness with which information is provided to the board of directors or committee members, to allow monitoring of management’s objectives and strategies, the entity’s financial position and operating results, and terms of significant agreements. For example, consider whether:
   a. The board of directors regularly receives key financial information, such as company financial statements and related analysis, the financial results of significant affiliates and business partners and changes to significant contracts.
   b. The board of directors regularly receives key information on strategic risk areas, such as investment strategies and results, reinsurance strategies and results, major marketing initiatives, results of negotiations and information on reasonably foreseeable prospective risks.
   c. The board of directors regularly receives key information on the actuarial function of the organization, such as reports and presentations on the adequacy of reserve provisions, the effectiveness of internal controls, and the prospective solvency position of the insurer.
   d. Directors believe they receive the proper information in a timely and effective manner.

6. The oversight in determining the compensation of executive officers and head of internal audit, and the appointment and termination of those individuals. Smaller or non-public companies are less likely to have the types of compensation policies and practices of larger, publicly traded companies, so the examination should take that fact into consideration. Some examples to consider may include:
   a. Whether the compensation committee, or board, approves executives’ incentive compensation plans.
   b. The general design philosophy of compensation and incentive programs.
   c. Whether the board or compensation committee considers how to eliminate, reduce, or manage material adverse risks to the company that may arise from compensation practices.
   d. Whether there have been any changes in executive compensation plans during the exam period. Review applicable SEC filings and the NAIC Supplemental Compensation Exhibit.
   e. The nature and extent of services provided by compensation consultants during the exam period. Are all services approved by the board of directors or compensation committee? How are independent compensation consultants selected and to whom do they report?
   f. How are management compensation programs reviewed for effectiveness?
   g. What is the process by which changes in compensation programs are approved?
   h. Does the compensation policy induce excessive or inappropriate risk-taking?
   i. Is the compensation policy in line with the identified risk appetite and long-term interests of the insurer with proper regard to the interests of the stakeholders?

7. The board’s role in establishing the appropriate “tone at the top.” For example, consider whether:
   a. The board and audit committee are involved sufficiently in evaluating the effectiveness of the “tone at the top.”
   b. The board of directors takes steps to ensure an appropriate tone.
   c. The board of directors specifically addresses management’s adherence to the code of conduct.
   d. The board of directors has developed an adequate conflict of interest policy for officers, management and key personnel.

8. The actions that the board of directors or committee takes as a result of its findings, including special investigations, as needed. For example, consider whether:
   a. The board of directors has issued directives to management detailing specific actions to be taken.
   b. The board of directors oversees and follows up as needed.

B. UNDERSTANDING THE ORGANIZATIONAL STRUCTURE

The organizational structure should not be so simple that it cannot adequately monitor the enterprise’s activities, nor so complex that it inhibits the necessary flow of information. Executives should fully understand their control responsibilities and possess the requisite experience and levels of knowledge commensurate with their positions. Key components include:
1. The appropriateness of the entity’s organizational structure, and its ability to provide the necessary information flow to manage its activities. For example, consider whether:
   a. The organizational structure is appropriately centralized or decentralized, given the nature of the entity’s operations.
   b. The structure facilitates the flow of information upstream, downstream and across all business activities.
   c. Checks and balances exist and are working as intended, allowing for flexibility and responsiveness in the timeliness of decision-making, transparency and concentration of power within the organization.
   d. For insurance groups, consider if group-wide governance policies address risks and objectives at the legal entity level and at the group level.

2. The adequacy of the definition of key managers’ responsibilities, and their understanding of these responsibilities. For example, consider whether:
   a. Responsibilities and expectations for the entity’s business activities are communicated clearly to the executives in charge of those activities.

3. The adequacy of knowledge and experience of key managers in light of responsibilities. For example, consider whether:
   a. The executives in charge have the required knowledge, experience and training to perform their duties.
   b. Key managers understand their responsibilities regarding the insurer’s risk policies/appetites and internal controls.

4. The appropriateness of reporting relationships. For example, consider whether:
   a. Established reporting relationships—formal or informal, direct or indirect—are effective and provide managers with information appropriate to their responsibilities and authority.
   b. The management of the business activities has access to senior operating executives through clear communication channels. The internal audit function reports directly to the board of directors or to the audit committee.

5. The extent to which modifications to the organizational structure and business strategy are made or planned in light of changing conditions. For example, consider whether:
   a. Management periodically evaluates the entity’s organizational structure in light of changes in the business or industry.
   b. For large insurance groups with significant affiliate relationships and interconnectivity (including systemically important financial institutions as designated by the Financial Stability Oversight Council), the board and management is involved in developing and reviewing resolution/contingency plans to be implemented in the event of company failure.

6. Sufficiency in the number of employees, particularly in management and supervisory capacities. For example, consider whether:
   a. Managers and supervisors have sufficient time to carry out their responsibilities effectively.
   b. Managers and supervisors work excessive overtime and/or are fulfilling the responsibilities of more than one employee.
   c. The insurer has succession plans established to replace/retain key employees.

7. The extent of accountability maintained for material activities or functions outsourced to an external party. For example, consider whether:
   a. Outsourced activities and functions are subject to periodic reviews by the insurer or an independent third party.
   b. Outsourced activities and functions are subject to the same degree of accountability as non-outsourced activities and functions.
C. UNDERSTANDING THE ASSIGNMENT OF AUTHORITY AND RESPONSIBILITY

The assignment of responsibility, delegation of authority and establishment of related policies provide a basis for accountability and control, and set forth individuals’ respective roles. Key components include:

1. The assignment of responsibility and delegation of authority to deal with organizational goals and objectives, operating functions and regulatory requirements, including responsibility for information systems and authorizations for changes. For example, consider whether:
   a. Authority and responsibility are assigned to employees throughout the entity.
   b. Responsibility for decisions is related to assignment of authority and responsibility.
   c. Proper information is considered in determining the level of authority and scope of responsibility assigned to an individual.

2. The appropriateness of control-related standards and procedures, including employee job descriptions. For example, consider whether:
   a. Job descriptions, for at least management and supervisory personnel, exist.
   b. The job descriptions, or other standards and procedures, contain specific references to control-related responsibilities.

3. The appropriateness of staff size, particularly with respect to information systems, actuarial and accounting functions, with the requisite skill levels relative to the size of the entity and nature and complexity of activities and systems. For example, consider whether:
   a. The entity has an adequate workforce—in numbers and experience—to carry out its mission.

4. The appropriateness of delegated authority in relation to assigned responsibilities. For example, consider whether:
   a. There is an appropriate balance between authority needed to “get the job done” and the involvement of senior personnel where needed.
   b. Employees at the appropriate level are empowered to correct problems or implement improvements, and empowerment is accompanied by appropriate levels of competence and clear boundaries of authority.

D. ASSESSING MANAGEMENT

A quality assessment of management may be determined through discussions and observations of the governance processes. This assessment should cover both the suitability of individual members of management as well as the suitability, policies and practices of management as a whole. As a general guideline, the following areas should be included in the assessment of management suitability.

1. Do key members of management appear to be suitable for their respective roles? Do they appear to possess the necessary competence and integrity for their positions?

2. How long has key management been with the company in their current positions, and what specific industry experience do they have?

3. Has there been significant turnover in management?

4. Have members of management ever been officers, directors, trustees, key employees or controlling stockholders of an insurance company that, while they occupied any such position or served in any such capacity with respect to it:
   a. Became insolvent or was placed in conservation?
   b. Was placed into supervision or rehabilitation?
   c. Was enjoined from, or ordered to cease and desist from, violating any securities or insurance law or regulation?
   d. Suffered the suspension or revocation of its certificate of authority or license to do business in any state?
In addition to the assessment of management suitability, examiners should make an assessment of management’s performance. The following areas should be considered when assessing management performance.

1. Does management periodically review information to adequately assess the impact of changes in competition, technology, regulation, environment and general economic trends that may impact the company’s business?

2. Does management have adequate financial and operating information to identify trends or variations from budgets that may impact the statutory financial statements?

3. Does management effectively analyze and investigate financial and operating information and trends such that significant adverse trends or misstatements in the annual financial statement could reasonably be expected to be identified and rectified on a timely basis?

4. Do management, supervisors and agents have appropriate knowledge and experience to capably and effectively administer management’s policies and procedures?

5. Does the company maintain effective controls to ensure that potential short-term liquidity problems, long-term capital needs and other significant fund management variations/needs are identified and rectified on a timely basis?

6. Do adequate physical safeguards exist over company assets, and are all officers and their employees appropriately bonded? (See Exhibit R – Suggested Minimum Amounts of Fidelity Insurance for assistance.)

7. Does management have a positive attitude toward internal controls (including controls over the information systems)?

8. Does management have adequate financial and operating information to identify, on a timely basis, potential liabilities, commitments and/or contingencies that may require recording and/or disclosure in the annual financial statement?

9. Does management regularly obtain and review key information on strategic risks, including investment strategies and results, reserving methodologies and results, reinsurance strategies and results, and information on reasonably foreseeable prospective risks?

As an expansion of the sample evaluative guidance above, the philosophy and operating style of management will normally have a pervasive effect on an entity. These are intangibles, but one can look for positive and negative signs. Key components include:

1. The nature of business risks accepted (e.g., whether management often enters into particularly high-risk ventures or is extremely conservative in accepting risks). For example, consider whether:
   a. Management moves carefully, proceeding only after carefully analyzing the risks and potential benefits of a venture.

2. Personnel turnover in key functions (e.g., operating, actuarial, accounting, information systems, internal audit). For example, consider whether:
   a. There has been excessive turnover of management and supervisory personnel.
   b. Key personnel have quit unexpectedly or on short notice.
   c. There is a pattern to turnover (e.g., inability to retain key financial or internal audit executives) that may be an indicator of the emphasis that management places on control.

3. Management’s attitude toward the information systems and accounting functions, and concerns about the reliability of financial reporting and safeguarding of assets. For example, consider whether:
   a. The accounting function is viewed as a necessary group of checks and balances, or as a vehicle for exercising control over the entity’s various activities.
b. The selection of accounting principles used in financial statements always results in the highest reported income.

c. Operating unit accounting personnel also have the responsibility to report to or communicate with central financial officers.

d. Valuable assets, including intellectual assets and information, are protected from unauthorized access or use.

4. Frequency of interaction between senior management and operating management, particularly when operating from geographically removed locations. For example, consider whether:
   a. Senior managers frequently visit subsidiary or divisional operations.
   b. Group or divisional management meetings are held frequently.

5. Attitudes and actions toward financial reporting, including disputes over the application of accounting treatments (e.g., selection of conservative vs. liberal accounting policies; whether accounting principles have been misapplied, important financial information not disclosed, or records manipulated or falsified). For example, consider whether:
   a. Management avoids obsessive focus on short-term reported results.
   b. Personnel do not submit inappropriate reports to meet targets.
   c. Managers do not ignore signs of inappropriate practices.
   d. Estimates do not stretch facts to the edge of reasonableness and beyond.

Management should provide effective oversight of the insurer’s actuarial function in evaluating and providing advice to the insurer in respect to technical provisions, premium and pricing, and reserving activities, and compliance with related statutory and regulatory requirements. While various components of an actuarial function can be provided internally or outsourced to an external third party, the following elements should be considered in understanding and assessing the insurer’s governance practices in this area:

1. Are individuals within the insurer’s actuarial function suitable for their respective roles? Do they possess the necessary competence and integrity for their positions?
   a. Does the insurer’s appointed actuary maintain current actuarial credentials with an appropriate professional organization (e.g., FCAS, MAAA, etc.)?
   b. Does the appointed actuary have experience in the lines of the business written by the company?
   c. Do others within the company’s actuarial function have the appropriate knowledge, experience and background to function in the roles assigned to them?

2. Does the insurer’s actuarial function provide advice on actuarial matters to management as appropriate based on the size and complexity of the entity? Key components include:
   a. The insurer’s actuarial and financial risks.
   b. The insurer’s current and prospective solvency position.
   c. Risk-assessment and risk-management policies and controls relevant to actuarial matters or the financial condition of the insurer.
   d. Distribution of policy dividend or other benefits.
   e. Underwriting policies.
   f. Reinsurance arrangements.
   g. Product development and design, including the terms and conditions of insurance contracts.
   h. The sufficiency and quality of data used in the calculation of technical provisions.
   i. Risk modeling and use of internal models in risk management.

3. Does the insurer have appropriate segregation of duties between its actuarial function and executive management to ensure that recorded reserves reflect an appropriate actuarial estimate?
   a. Recorded reserves reflect an appropriate actuarial estimate (P&C and Health)?
   b. The company books the actuary’s best estimate each year (P&C and Health)?
   c. If the company’s recorded reserves differ from the actuary’s best estimate, is the rationale for such deviation appropriately documented and presented to the board of directors (P&C and Health)?
d. The company’s appointed actuary has submitted a report to the Board of Directors on reserve adequacy (All Lines).

E. REVIEWING THE RISK MANAGEMENT FUNCTION

A review of the entity’s risk management function should be conducted through discussions with senior management and the board of directors and through gaining an understanding of the risk management function including inspection of relevant risk management documentation. For companies subject to the Own Risk and Solvency Assessment (ORSA), a review of the ORSA summary report—including completion of the ORSA Documentation Template in Section 1, Part X of this Handbook—may be used in place of completing this section. For companies that do not submit an ORSA summary report, the ORSA guidance contained in this Handbook may still be a helpful tool for the examiner to consider in assessing the maturity of an insurer’s risk-management framework, which should include an assessment of each of five key principles. While each of the key principles can be applicable to all insurers, it is important to consider variations in size and complexity and alter expectations appropriately. As a general guideline, the following areas should be considered in conducting a review of the risk-management function:

1. Risk Culture and Governance
   a. What kind of risk-management culture is demonstrated throughout the organization? What does the culture indicate regarding the importance of risk management to the organization?

2. Risk Identification and Prioritization
   a. How are existing risks identified, monitored, evaluated and responded to? Does risk assessment take probability, potential impact and time duration into account?
   b. How are emerging and/or prospective risks identified, monitored, evaluated and responded to?

3. Risk Appetite, Tolerances and Limits
   a. How are risk tolerances, appetites and limits defined and communicated throughout the organization? Does the insurer maintain appropriate policies outlining specific obligations of employees in dealing with risk?
   b. How does the organization use the risk information it gathers to determine its capital needs?

4. Risk Management and Controls
   a. How are responsibilities for risk-management functions delegated and monitored within the organization?

5. Risk Reporting and Communication
   a. What is the involvement of the board of directors in the risk-management function of the organization?

An effective risk-management function is essential in providing effective corporate governance over financial solvency. During the latter phases of the risk-focused examination, the examiner will document a review of the entity’s individual risk-management functions within the system. However, during a review of the entity’s corporate governance, the examiner should document the review of the entity’s risk-management function as a whole, as well as its place and importance in the entity’s corporate governance structure. For ORSA companies, the knowledge gained in performing a review and assessment of enterprise risk management (ERM) may also be utilized to gain efficiencies, if appropriate, in accordance with the insurer’s assessed maturity level, in the latter phases of the risk-focused examination as described in Section 1, Part X of this Handbook.

F. DOCUMENTATION

The examination team should document its understanding and assessment of the entity’s governance, as well as its assessment on the related impact on the examination. This summary should include a description of any unique examination procedures, including special inquiries that are considered necessary to any significant risks identified as a result of the assessment.
The Risk Assessment Matrix, as the central documentation tool, should be utilized for the identification and assessment of individual solvency risks requiring review through the risk assessment process. However, documentation on the understanding and assessment of corporate governance is at the discretion of the examiner and would not typically be presented in a Risk Assessment Matrix. For most companies, a memorandum and/or corresponding documentation in the electronic workpapers addressing the items presented in this exhibit should provide sufficient documentation. For example, the documentation could summarize the attributes and techniques supporting the examiner’s overall evaluation, any resulting examination scope implications, and the approach used to validate the more significant attributes and techniques. For smaller companies, documentation of the examination’s consideration of corporate governance may be provided in the appropriate section of Exhibit I – Examination Planning Memorandum.

Specific findings or concerns related to an insurer’s corporate governance practices should be accumulated for inclusion in a management letter (or similar document) to provide feedback and recommendations to the insurer. In addition, it may be necessary for the examination to document information on the corporate governance assessment for communication back to the financial analyst through the use of Exhibit AA – Summary Review Memorandum (or similar document).
Sample Interview Questions for Board or Committee Members

Experience and Background
• How has your professional experience and background prepared you to serve on the board of directors for this company?

Duties and Responsibilities
• How often does the board/committee meet? Why is that sufficient?
• Briefly describe your duties and responsibilities, including what types of company information you monitor on a continuous basis.
• How does management establish objectives and how does the board of directors monitor achievement of those objectives?
• What role does the board of directors play in determining executive compensation?
• What areas are discussed and what type of decisions are made by the board/committee?
  - How does the board ensure that sufficient information is received to make informed decisions on behalf of the company?
• Does the board/committee review related-party transactions?
• What role does the board/committee play in overseeing the actuarial function as well as associated internal controls?

Reporting Structure
• Describe the reporting structure of the company, including who reports to the board/committee.
• Describe the interaction the board of directors has with the internal/external auditors, shareholders and senior management.

Ethics
• Does the company have a code of conduct/ethics in place? Is it enforced? Approved?
• Explain the commitment to ethics by the board/committee and explain how the board/committee conveys that commitment to employees.
  - How does the board obtain an understanding of the “tone” throughout the organization?
• How does the company compare to others, in terms of its position on ethics?
• Do you have any knowledge or suspicion of fraud within the company?

Risk Areas
• How does the board identify and monitor key risks faced by the company?
  - What are the key risks the board has identified?
  - What are the key prospective risks the company faces?
• Does the board review any type of stress testing?

Risk Mitigation Strategies (Internal Controls)
• How often does the board receive reports from management on the internal controls of the company?
  - What information is reported?

Corporate Strategy
• How is the board involved in significant corporate strategy decisions?
• Does the board approve an annual business plan?
• How does the board gain comfort with total exposures and the risk/return trade-offs?
• Where is the company headed strategically? What type of plan is in place to implement this strategy? Has it been approved? How is it being monitored?
• Is the corporate strategy effectively communicated between senior management and the rest of the company?
• Explain any strengths or weaknesses of the company, as well as opportunities or threats, the company is facing and how the company is responding to each.
• If part of a holding company:
  - How does the holding company contribute to the company’s strategy?
• How might the holding company be impacted by the company’s strategy?

Other Topics
• Explain any significant turnover in senior management or on the board/committee.
• What type of succession planning does the company have in place?
• Based on the current economic climate, are there any other competencies/skills that would be useful to the board?
• Is the current size of the board sufficient to fulfill necessary oversight responsibilities?
• How does the company monitor and assess financing needs, as well as access to capital?
• How does the company monitor, assess and respond to information security risks (including those related to cybersecurity threats)?
Sample Interview Questions for the Chief Executive Officer

Experience and Background
- How has your professional experience and background prepared you to serve as the Chief Executive Officer for this company?

Duties and Responsibilities
- Briefly describe your duties and responsibilities.
- How does management establish objectives and how is the achievement of those objectives monitored?
- What role do you play in the hiring of senior management and determining executive compensation?
  - How is your compensation determined?
- How do you support the operations and administration of the board?
  - Briefly describe your oversight responsibilities regarding the company’s actuarial function?

Reporting Structure
- Describe the reporting structure of the company, including to whom you report, as well as those reporting to you.
- Explain the function and reporting structure of your senior management team.
  - How often are you in contact with them?
- Describe your interaction with the board of directors.

Ethics
- Does the company have a code of conduct/ethics in place? Is it enforced? Approved?
- Explain management’s commitment to ethics and explain how management conveys that commitment to employees.
  - How does management obtain an understanding of the “tone” throughout the organization?
- When establishing ethics, does the company evaluate what other companies have implemented? If yes, how does the company compare?
- Do you have any knowledge or suspicion of fraud within the company?

Risk Areas
- How are key risks faced by the company identified and monitored?
  - What are the key prospective risks the company faces?
  - How are these risks communicated to senior management and throughout the company?
- Describe any stress testing performed by the company.

Risk Mitigation Strategies (Internal Controls)
- What is the formal procedure for reporting on risk management to senior management and the board?
- Explain your commitment to the internal control structure.
- What is your company’s plan for operating in crisis/disaster – business continuity?
- From a strategic perspective, how are risks addressed across all business units and entities?

Corporate Strategy
- Where is the company headed strategically? What type of plan is in place to implement this strategy? Has it been approved? How is it being monitored?
- What are your plans for retaining and growing business?
- Explain what types of tools and/or reports you utilize to make key business decisions.
- Explain any strengths or weaknesses of the company, as well as opportunities or threats, the company is facing and how the company is responding to each.
- What key measures do you assess to evaluate the company’s performance and competitive position?
- If part of a holding company:
  - How does the holding company contribute to the company’s strategy?
- How might the holding company be impacted by the company’s strategy?
- How often do you discuss corporate strategy with your direct reports?

Other Topics
- Explain any significant turnover in senior management and/or on the board/committee.
- What type of succession planning does the company have in place?
- How does the company monitor and assess financing needs, as well as access to capital?
- How does the company monitor, assess and respond to information security risks (including those related to cybersecurity threats)?
Sample Interview Questions for Chief Risk Officer

Experience and Background
- How has your professional experience and background prepared you to serve as the Chief Risk Officer for this company?

Duties and Responsibilities
- Briefly describe your duties and responsibilities.
- How does your role/function relate to, or how is it integrated with Sarbanes-Oxley Act and/or NAIC Annual Financial Reporting Model Regulation (Model Audit Rule) processes, internal audit and/or other departments?
- Describe the major projects taking place and how you divide your departments time (i.e., what are the areas of focus)?
- Do you publish reports/findings?
  - To whom are they distributed and how often are they distributed?

Reporting Structure
- Describe the reporting structure of the company, including to whom you report, as well as who reports to you.
- Is there a board-level committee or other group that you report to?
  - Is that group independent from your area of management?
  - What is their role and how do you interact with them?
- Describe those who have been involved (e.g., your team, internal audit, operational areas, consultants, external auditors, etc.) and their roles in the Model Audit Rule compliance process.
- Are there any financial ties to company profits within your compensation package?

Ethics
- Does the company have a code of conduct/ethics in place? Is it enforced? Approved?
- Explain management’s commitment to ethics and explain how management conveys that commitment to employees.
- When establishing ethics, does the company evaluate what other companies have implemented? If yes, how does the company compare?
- Do you have any knowledge or suspicion of fraud within the company?

Risk Areas
- How are key risks faced by the company identified and monitored?
  - What are the key prospective risks the company faces?
  - How are these risks communicated to senior management and throughout the company?
- Do you monitor risks relevant to specific components or divisions within the entity?
- What key risks do you monitor in your position?
  - What reports or other means do you utilize to evaluate the risks?
- Does your company consider the impact of climate change risks as part of its overall risk management practices?
  - If so, what risks have you identified related to the impact of climate change risks?
  - If so, what is done to analyze and mitigate each of those risks? Is this done independently or as part of weather-related risks in general?

- Are you involved in the company’s process for establishing and monitoring reserving risks?
  - If so, please describe the company’s process to establish and monitor reserving risks.

Risk Mitigation Strategies (Internal Controls)
- What is the formal procedure for reporting on risk management to senior management and the board?
- What is the company’s plan for operating in crisis/disaster – business continuity?
- From a strategic perspective, how are risks addressed across all business units and entities?
- How has the Model Audit Rule affected the company, if at all? How has it affected the holding company and/or the internal audit department?
• Does the organization structure allow for proper segregation of duties?
• What internal controls exist to ensure adherence to company policies and procedures, as well as regulatory procedures?
• What procedures are in place to diversify risks?
• What strategies are used for managing the most significant risks facing the company?
• Are executive officers and management team members required to disclose personal business or family relationships with organizations in which your company invests?
• Describe any compliance-related training conducted by the organization.
  - Is the training required?
• Are quality reviews performed by internal auditors or other means within the company?
• How are goals set and performance evaluated?
  - How is that linked to responsibility and accountability?
  - How does all of that impact the divisional level?
• What is the nature and extent of incentive compensation throughout the company?
  - How are risks related to compensation identified, monitored and mitigated?

Corporate Strategy
• Explain strengths or weaknesses of the company, as well as opportunities and threats the company is facing, and how the company is responding to each.

Other Topics
• Do you have an organization-wide integrated risk management framework?
• Explain the company’s involvement in transactions that include derivative risks.
• Is the company subject to any derivative risks that are not disclosed within Schedule DB of the Annual Statement? If so, please explain.
Sample Interview Questions for the Chief Actuary

Experience and Background
• How has your professional experience and background prepared you to be the Chief Actuary for this company?

Duties and Responsibilities
• Briefly describe your duties and responsibilities.
• How does management establish objectives, and how is the achievement of those objectives monitored?
  - How is your performance evaluated? Is it based on the performance of the company?

Reporting Structure
• Describe the reporting structure of the actuarial function, including to whom you report, as well as those reporting to you.
• Is there a reserving committee?
  - How is it organized and who are its members?
  - How are differences resolved?
• Describe your interaction with the CFO/CEO/BOD.
  - Do you provide them with any specific reports?
• Do the board/audit committee members demonstrate an understanding of the variability inherent in the reserves?
  - How does the board/committee oversee the application of Principle Based Reserving (if applicable)?

Ethics
• Does the company have a code of conduct/ethics in place? Is it enforced? Approved?
• Explain management’s commitment to ethics and explain how that commitment is conveyed to employees.
• Do you have any knowledge or suspicion of fraud within the company?

Risk Areas
• How are key legal and regulatory risks faced by the company identified and monitored?
  - What are the key prospective risks the company faces?
  - How are these risks communicated to senior management and throughout the company?
• Have there been changes in the appointed actuary in recent years and, if so, how often have such changes occurred and why?
  - What is the current reinsurance program? Describe any changes over the past five years.
  - Describe the company’s process to establish Principle Based Reserves.
    ◼ Does the company have credible experience or experience studies to substantiate the model assumptions?
    ◼ Does the company use a vendor supplied or internally developed Cash Flow Model?

Risk Mitigation Strategies (Internal Controls)
• What is the formal procedure for reporting on risk management to senior management and the board.
• What controls are in place to ensure reserving guidelines are followed?
• Who determines which reserves will be booked in the financial statements quarterly and/or annually?
  - Does the company book to the actuary’s point estimate, or is there a monitored gap?
• How often are full reserve analyses performed?
• Does the company book to the actuary’s point estimate, or is there a monitored gap?
• Is the actuarial opinion signed by a company actuary or a consultant?
• Does the company use commercial software or “homegrown” spreadsheets? What controls are in place to check for errors?
• How are pricing and underwriting monitoring integrated into the reserving process?
• Is there a peer review of the reserving actuary’s work? If so, who performs it?
  - How much reliance does the appointed actuary place on the work of others?
  - Describe the controls in place over the PBR processes.
• Has the company instituted any new controls as a result of the implementation of Principle Based Reserving (if applicable)?
• Describe the modeling controls in place supporting the Principle Based Reserving processes (e.g. model validation, changes in modeling assumptions, etc.).

Corporate Strategy
• Give a general description of the company’s reserving philosophy.
• Explain what types of tools or reports you utilize to evaluate actuarial decisions.
Other Topics

- What is the quality of the actuarial report, with respect to completeness and clarity of documentation?
- What actions have been taken to apply PBR methodologies? Steps have been, or will be, taken to prepare for the implementation of principle-based reserving (PBR)? (Life Insurers Only)
  - How are system capabilities considered in preparation for PBR implementation?
  - What system changes were made to apply PBR?
  - How are staffing needs, appropriate expertise and availability of effective training evaluated in preparation for PBR implementation?
  - What changes to staffing and training were made to apply PBR?
  - Discuss management’s commitment to successful implementation of PBR.
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To: Judy Weaver, Chair of the Financial Analysis Handbook (E) Working Group and Susan Bernard, Chair of the Financial Examiners Handbook (E) Technical Group

From: James Kennedy, Chair of the Receivership Model Law (E) Working Group

Date: May 16, 2017

Re: Receivership Provisions in Management, Service and Cost-sharing Agreements

The Receivership Model Law (E) Working Group (RMLWG) has identified that because of the increasing occurrence of holding company relationships, non-regulated entities that are operationally related to insurers frequently present a challenge when the insurer is in receivership. In many cases the issues may be resolved if certain language addressing receivership of the insurer is included in the affiliated agreements. Additionally, how the U.S. receivership regime handles nonregulated entities in receivership was an issue identified by the International Monetary Fund (IMF) during the Financial Sector Assessment Program (FSAP) review.

The NAIC adopted revisions to the *Insurance Holding Company Model Regulation and Reporting Forms* (Model #450) in 2010 to require specific language in management, service and cost-sharing agreements specific to when an insurer is placed into receivership, as follows. At this time, most states have adopted the following revision to their regulation, with few exceptions.

Section 19. Transactions Subject to Prior Notice - Notice Filing

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

(11) Specify that, if the insurer is placed in receivership or seized by the commissioner under the State Receivership Act:

a. all of the rights of the insurer under the agreement extend to the receiver or commissioner; and,

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

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

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


If there are any questions regarding this referral, please feel free to contact the Chair or NAIC staff support (Jane Koenigsman) to discuss.
III. GENERAL EXAMINATION CONSIDERATIONS

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

A. General Information Technology Review
B. Materiality
C. Examination Sampling
D. Business Continuity
E. Using the Work of a Specialist
F. Outsourcing of Critical Functions
G. Use of Independent Contractors on Multi-State Examinations
H. Comments and Grievance Procedures Regarding Compliance with Examination Standards

F. Outsourcing of Critical Functions

The examiner is faced with additional challenges when the insurer under examination outsources critical business functions to third-parties. It is the responsibility of management to determine whether processes which have been outsourced are being effectively and efficiently performed and controlled. This oversight may be performed through a number of methods including performing site visits to the third-party or through a review of SSAE 16 work that has been performed. In some cases, performance of site visits may even be mandated by state law. However, regardless of where the business process occurs or who performs it, the examination must conclude whether financial solvency risks to the insurer have been effectively mitigated. Therefore, if the insurer has failed to determine whether a significant outsourced business process is functioning appropriately, the examiner may have to perform testing of the outsourced functions to ensure that all material risks relating to the business process have been appropriately mitigated. The guidance below provides examiners additional information about the outsourcing of critical functions a typical insurance company may utilize. The guidance does not create additional requirements for insurers to comply with beyond what is included in state law, but may assist in outlining existing requirements that may be included in state law and should be used by examiners to assess the appropriateness of the company’s outsourced functions. Within the guidance, references to relevant NAIC Model Laws have been included to provide examiners with guidance as to whether compliance in certain areas is required by law. To assist in determining whether an individual state has adopted the provisions contained within the referenced NAIC models, examiners may want to review the state pages provided within the NAIC’s Model Laws, Regulations and Guidelines publication to understand related legislative or regulatory activity undertaken in their state.

Types of Third-Party Administrators/Service Providers

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

- Managing General Agent – Person who acts as an agent for such insurer whether known as a managing general agent, manager or other similar term, who, with or without the authority, either separately or together with affiliates, produces, directly or indirectly, and underwrites an amount of gross direct written premium equal to or more than five percent (5%) of the policyholder surplus as reported in the last annual statement of the insurer in any one quarter or year together with the following activity related to the business produced adjusts or pays claims in excess of $10,000 per claim or negotiates reinsurance on behalf of the insurer.

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

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

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

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

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

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

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

---Detail Eliminated to Conserve Space---

**Affiliated Service Providers**

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

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

1. Identify the person providing services and the nature of such services;
2. Set forth the methods to allocate costs;
3. Require timely settlement, not less frequently than on a quarterly basis, and compliance with the requirements in the Accounting Practices and Procedures Manual;  
4. Prohibit advancement of funds by the insurer to the affiliate except to pay for services defined in the agreement;  
5. State that the insurer will maintain oversight for functions provided to the insurer by the affiliate and that the insurer will monitor services annually for quality assurance;  
6. Define books and records of the insurer to include all books and records developed or maintained under or related to the agreement;  
7. Specify that all books and records of the insurer are and remain the property of the insurer and are subject to control of the insurer;
8. State that all funds and invested assets of the insurer are the exclusive property of the insurer, held for the benefit of the insurer and are subject to the control of the insurer;

9. Include standards for termination of the agreement with and without cause;

10. Include provisions for indemnification of the insurer in the event of gross negligence or willful misconduct on the part of the affiliate providing the services;

11. Specify that, if the insurer is placed in receivership or seized by the commissioner under the State Receivership Act:
   a. all of the rights of the insurer under the agreement extend to the receiver or commissioner; and,
   b. all books and records will immediately be made available to the receiver or the commissioner, and shall be turned over to the receiver or commissioner immediately upon the receiver or the commissioner’s request;

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

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

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

Comment Letters:

• American Academy of Actuaries
• Fontaine Consulting, LLC
• Joint Interested Parties
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August 15, 2017

Ms. Susan Bernard
Chair, Financial Examiners Handbook (E) Technical Group
National Association of Insurance Commissioners

Dear Ms. Bernard,

The Principle-Based Reserving Review Procedures Work Group of the American Academy of Actuaries1 appreciates the opportunity to provide comments on the June 29, 2017, exposure of proposed changes to the Financial Condition Examiners Handbook.

In general, the work group believes the exposure draft represents a significant improvement over the current framework by including a new section for Life Insurance Reserves Review and additional considerations in the Corporate Governance and Life Exam Repository for Principle-Based Reserve (PBR) Revisions. The work group does, however, recommend some substantive changes detailed below.

**Recommended Changes to the Exposure**

1.) Section III.E.1.6 and III.E.6

The work group suggests the following edits to clarify the description of which business requires actuarial involvement because “significant uncertainty in the appropriateness and/or amount of actuarial reserves” may apply to health insurers, credit insurers and, in some cases, term life insurers not subject to PBR.

*Section III.E.1 Decision to Use the Work of a Specialist*

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

1. **Life and Health company examinations where the company has a substantial amount of interest-sensitive business, has a substantial amount of the actuarial reserves that entail significant judgment, or the company has a substantial amount of business subject to PBR calculations or PBR exclusion tests require the involvement of a credentialed actuary to perform an evaluation of reserves.** (emphasis added)

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1 The American Academy of Actuaries is a 19,000-member professional association whose mission is to serve the public and the U.S. actuarial profession. For more than 50 years, the Academy has assisted public policymakers on all levels by providing leadership, objective expertise, and actuarial advice on risk and financial security issues. The Academy also sets qualification, practice, and professionalism standards for actuaries in the United States.
b. Property & Casualty company examinations where the company has a substantial amount of long-tail lines of business require the involvement of a credentialed actuary to perform an evaluation of loss reserves.

Section III.E.6: Actuarial Specialist

As previously noted, the involvement of a credentialed actuary is required on all examinations of property/casualty insurers with a substantial amount of long-tail lines of business and life and health insurers with a substantial amount of interest-sensitive business, a substantial amount of actuarial reserves that entail significant judgment, or when the company has a substantial amount of business subject to principle-based reserve (PBR) calculations or subject to PBR exclusion tests… (emphasis added)

2.) Section VI.B. Second paragraph

We suggest changing “The mortality rate assumptions are substantially higher…” to “The mortality assumptions are higher…” because when X-factors are applied or super-preferred underwriting classes are used as permitted, the mortality assumptions may be minimally higher than underwriting experience.

3.) Section VI.B. Third paragraph

We suggest significant changes to the third paragraph to more accurately describe the commonly used formulaic reserving methods for statutory life insurance reserves. Our recommended wording for the revision of paragraph is provided below for your consideration:

There are three general valuation methods under a formula based valuation methodology commonly used to value statutory life reserves. Each of these methods assigns reserves equal to the present value of future benefits less the present value of future premiums. The methods differ in how expenses are recognized. The net level premium method (NLP) uses net premiums and does not recognize any expenses. Therefore, this method often results in the most conservative, or highest, life reserve valuation of the three methods.

The full preliminary term method (FPT) recognizes for an expense allowance in the first year. Under FPT the reserves in the first year are computed as if the policy were a one-year term insurance policy. After the first year, reserves are computed using the NLP method with the policy assumed to be issued at the beginning of its second year. The net premiums after the first year under the FPT are higher than the NLP premiums. The Commissioners Reserve Valuation Method (CRVM) is a modified blend of the full preliminary term and net level premium methods. It allows the first year’s net premium as an expense allowance and then spreads that expense allowance over the policy’s coverage period or 19 years, whichever is less. This method allows for a lower life reserve valuation than the net level premium method in the earlier years of the policy term. The CRVM results in a reserve valuation which grades from $0 in the first year to the NLP over a period of up to 20 years.
4.) Section VI.B. (New Section) Credit Life Reserves

We suggest adding a section on “Credit Life Reserves” between sections 3 (Industrial Life Reserves) and 4 (Life Reserves Related to Riders) on page 12. Credit insurance is a distinct line of business in the annual statement and has a separate section in the Valuation Manual. Its inclusion is recommended for completeness.

The following language is offered for your consideration:

Credit life insurance policies are designed to discharge a debt upon the debtor’s death. They are usually funded as a single premium. Reserves requirements vary among the states. Key considerations include claims reserves and policy reserves based on some state-specified combination of mortality reserves, unearned premium reserves, and potential refunds. Credit Life and Disability Reserves are addressed in Valuation Manual (VM)-26.

5.) Section VI-C

We suggest the second paragraph be moved to follow the third paragraph for clarity. The reserve liability is described in the paragraph that starts with “The principle-based valuation methodology…” The stochastic reserve (SR) is one of the components used to determine the reserve liability under PBR. We recommend changing the first sentence of the paragraph that describes the SR from “The reserve liability…” to “The stochastic reserve…”

6.) Section VI-E. Actuarial Oversight and Internal Controls

We suggest the technical group consider including the responsibilities of the qualified actuaries as described in VM-G. The Valuation Manual has recommendations for the board and management, and includes governance requirements for the qualified actuaries. The qualified actuaries’ adherence to these requirements should be included in the governance portion of any examination.

*****

Should you have questions regarding these suggestions, please contact Ian Trepanier, the Academy’s life policy analyst, at trepanier@actuary.org.

Sincerely,

Randall Stevenson, MAAA, ASA, MSc
Chairperson, Principle-Based Reserving Review Procedures Work Group
American Academy of Actuaries
Baily,

I would like to offer the following suggested language changes for consideration to some of the exposed items in the Repository - Reserves/Claims Handling changes:

Several examples (starting on p.21) use the language: “Utilize a Department actuary, consulting actuary or NAIC Actuarial Modeling support staff to”…

The language contained in other parts of the repository (older language and language added to Reinsurance repository – see p.63) is as follows: “utilize the insurance department actuary or an independent actuary to”

The highlighted current language in the handbook uses the term “independent actuary” while the newer language, in some instances, uses the term “consulting actuary”. While I do not express a preference for either term, I believe there are fewer new references to “consulting actuary, therefore I recommend using the consistent language of “insurance department actuary or an independent actuary” in the additional examples.

Alice Fontaine, FSA, FCIA, MAAA
President & Consulting Actuary
Fontaine Consulting, LLC
100E. Whitestone Blvd., Suite 148-288
Cedar Park, TX 78613

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August 15, 2017

Ms. Susan Bernard  
Deputy Commissioner, California Department of Insurance  
Chair, NAIC Financial Examiners Handbook (E) Technical Group

Re: Comments on Financial Examiners Handbook Revisions

Dear Deputy Commissioner Bernard:

The undersigned submit the following comments regarding the current exposure for proposed revisions to the Financial Examiners Handbook.

- On Page 3, Exhibit A - We believe the following additional guidance should be added to emphasize that the initial planning meeting with the analyst should occur prior to any requests being sent to the company. “Whenever possible, the in-person or teleconference planning meeting with the department analyst should occur prior to sending the company the initial records request.”

We suggest further enhancing the examination guidance to indicate that prior to States sending out the Exhibit B to the company, regardless of when the planning meeting occurs, that the Exhibit B is also sent to and thoroughly reviewed by the analyst for information that is already available at the state insurance department. For consistency, we recommend adding the following guidance to the Financial Examiners Handbook currently on page 27 in the Financial Analysis Handbook:

“Communicate and provide access to relevant information that has already been obtained by the analyst function and is available to the state insurance department. It may be helpful for the analyst to review the Examiner’s Exhibit B questionnaire and note specific items that have already been accumulated and available to the examiner.”

- On Page 35, regarding segregation of duties between the actuarial function and executive management, Items 3.b and 3.c should only be for P&C. Any reference to Health should be eliminated since health reserves are not based on best estimates.

- On Page 47 and 48, the “Affiliated Service Provider” is listed under the Third Party Administrator section. It should be removed from that listing. We appreciate your consideration of our comments and look forward to the next technical group discussion and in the interim please let us know if you have any questions.
The interested parties, as noted below, agree with the comments contained in this letter.

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Attachment Three

Proposed Revisions Related to Referral from Financial Analysis (E) Working Group

• FAWG Referral
• Section 1-3: Run-off Examinations
• Section 2-1: Redomestication
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MEMORANDUM

TO: Susan Bernard, Chair, Financial Examiners Handbook (E) Technical Group

FROM: Doug Slape, Chair, Financial Analysis (E) Working Group

DATE: April 26, 2017

RE: Enhanced Regulatory Guidance

As you may be aware, the Financial Analysis (E) Working Group (FAWG) meets annually in Kansas City to discuss among other things, potentially troubled insurers and insurance groups. During this same meeting, the FAWG discusses industry trends, including identifying any that are potentially adverse or might warrant communication and coordination with other NAIC groups. As a result of the issues and trends discussed, the FAWG would like to refer four items to the attention of your group.

1. **Runoff Exams** – The first item relates to how the exam process would be performed in situations where an insurer is in run-off. In this situation the risks of the organization may change, making it appropriate to narrow the focus of an exam to those issues most relevant to run-off insurers and reducing the potential strain on resources. In conducting these exams, we recommend that liquidity and staffing be specifically considered to address common issues identified by FAWG. Therefore, we encourage the development of additional guidance and training in this area as necessary, to address the issues identified.

2. **Corporate Governance** – The second item relates to how examiners consider a company’s corporate governance during the course of an exam. FAWG continues to identify troubled company situations that are due in part to poor corporate governance practices. In some cases, corporate governance was assessed as strong or adequate on a previous exam based on its form, but the actual substance of corporate governance turned out to be deficient. Therefore, we recommend that handbook guidance be reviewed and training be developed to look beyond written policies, procedures and structure to challenge the operating effectiveness of the processes in place.

3. **Redomestication** – The third item relates to communication between states in situations where a company has re-domesticated since the last full-scope examination. FAWG has identified situations where regulators have not incorporated insights from the former domestic state’s supervisory plan into future examinations. In these situations, it is imperative that regulator concerns be appropriately transitioned to avoid losing regulatory insights accumulated over years of oversight. Therefore, we encourage the development of additional guidance and training in this area as necessary, to address the issues identified.

4. **Expansion of Business** – The forth item relates to risks associated with the expansion of business. Such risks may emerge as companies consider expansion (either by geographical area of operation or products offered), where without the right expertise and/or plan, a company can experience significant losses that threaten their solvency. Therefore, we encourage the development of additional guidance and training in this area as necessary, to address the issues identified.

In considering these issues, FAWG recommends considering existing guidance in the Examiners Handbook to ensure it sufficiently addresses the concerns above. Moreover, we recommend considering whether additional training would be beneficial to assist regulators in addressing the concerns during the course of financial exams.

If there are any questions regarding the proposed recommendation, please contact me or NAIC staff (Bruce Jenson at bjenson@naic.org) for clarification.

Thank you for your consideration.
III. GENERAL EXAMINATION CONSIDERATIONS

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

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

H. Considerations for Insurers in Run-Off

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

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

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

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

Loss and LAE Reserves

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

I. Comments and Grievance Procedures Regarding Compliance with Examination Standards

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

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

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

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

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PHASE 1 – UNDERSTAND THE COMPANY AND IDENTIFY KEY FUNCTIONAL ACTIVITIES TO BE REVIEWED

In Phase 1 of a risk-focused examination, key activities will be confirmed or identified using background information gathered on the company from various sources. Some of this information will already have been available in the department prior to the initial planning meeting, or can be obtained from the company’s internal audit department or external auditors. A Phase 1 goal is to gather any additional or current information necessary to begin a risk-focused examination. Sources of information may include organizational charts, filings required by sections 302 and 404 of the Sarbanes-Oxley Act of 2002 (where applicable), interviews with senior management, or other publicly available information.

To ensure the appropriate risk-focused examination scope, it is important to identify the key functional activities (i.e., business activities) of the company. Information gathered by understanding the company, the company’s corporate governance structure, and assessing the company’s audit function will form the basis for determining key activities.

Essential to executing the risk-focused surveillance process is interviewing executive management and possibly board members of the company to identify key activities and risks. Risks identified through these interviews and each part of Phase 1 should be documented on Exhibit CC – Issue/Risk Tracking Template or a similar document to ensure they are carried through the remaining phases of the examination. Examiners and company officials should attempt to maintain an ongoing dialogue to assist the examiners in understanding the company and identifying key functional activities. It is also critical for the examination team to understand and leverage the company’s risk management program; that is, how the company identifies, controls, monitors, evaluates and responds to its risks. For companies required to submit an Own Risk and Solvency Assessment (ORSA) summary report, the report provided by the company may be a useful tool in this evaluation. The discipline and structure of risk management programs vary dramatically from company to company. “Best practices” are emerging for risk management programs and more companies are appointing chief risk managers whose responsibilities go well beyond the traditional risk management function (the buying of insurance). The Committee of Sponsoring Organizations (COSO) has published internal control standards that are widely-held, although not required, in many industries and has released an Enterprise Risk Management Integrated Framework, which is anticipated to be incorporated by several entities, as well as guidance to apply the integrated framework and internal control standards to small public companies. The examination team should evaluate the strength of the company’s risk management process, which can include a “hind-sight” evaluation of why a particular negative surprise or event occurred (i.e., why was it not identified in the current risk management program of the company).

There are five parts to Phase 1 that are key components of performing a risk assessment, the results of which drive the direction of the risk-focused examination: (1) Understanding the Company; (2) Understanding the Corporate Governance Structure; (3) Assessing the Adequacy of the Audit Function; (4) Identifying Key Functional Activities; and (5) Consideration of Prospective Risks for Indications of Solvency Concerns. The Risk Assessment Matrix (Exhibit K), the tool developed to serve as the central location for the documentation of risk assessment and testing conclusions, should be updated with the identified key activities of the company after the examiner is able to obtain an understanding of the company and corporate governance structure. The five parts of Phase 1 are discussed in detail below.

A. Part 1: Understanding the Company

Step 1: Gather Necessary Planning Information

Meet with the Assigned Analyst

Gathering information becomes the first step in gaining an understanding of the company. While general information may have been requested from the company during examination pre-planning through use of Exhibits B and C, the examination team should determine what other information is already available to the department before making additional information requests. To do so, the examination team should meet (in-person or via conference call) with the assigned financial analyst (and/or analyst supervisor) prior to requesting additional information for use in examination planning. An email exchange, in and of itself, is not deemed sufficient to achieve the expectation of a planning meeting with the assigned analyst.
In addition to gaining an understanding of the information already available to the department, the meeting with the analyst should focus on the company’s financial condition, prospective risks and operating results since the last examination. The analyst should be asked to discuss risks and concerns highlighted in the Insurer Profile Summary and to describe the reasons for unusual trends, abnormal ratios and transactions that are not easily discernible. The analyst may also request specific matters or concerns for verification and review during the financial examination. To summarize the input received from financial analysis, the examination team should document risks identified by the analyst for further review on the examination and post significant items to Exhibit CC – Issue/Risk Tracking Template for incorporation into the examination process.

If the company under examination has redomesticated since the prior exam, the department analyst will typically take a primary role in communicating with the prior domestic regulator in order to adequately transfer regulatory insights accumulated over years of oversight. The department analyst would then share these insights with the examiner in charge during the examiner/analyst meeting during the planning phase of the examination. This communication may include a discussion of the Insurer Profile Summary and key risks, the supervisory plan, the former regulator’s assessment of Senior Management, the Board of Directors and corporate governance, and other relevant solvency monitoring information. If after meeting with the analyst the examiner requires additional information or further clarification, the examiner may consider contacting the former regulator.

The avoidance of redundancy between analysis and examination processes is of critical importance for an enhanced and more efficient overall regulatory process that will benefit both regulators and industry. An efficient regulatory process fosters clarity and consistency, which results in a better understanding of how individual insurers operate across the different aspects of the regulatory spectrum, including the areas of financial examination, financial analysis and other solvency-related regulation.

By utilizing information and input provided by the analysts, the examination team can request updates to existing information available to the department rather than duplicating requests for information already provided to the analyst. This process eliminates the need for examiners to redevelop the financial analysis information in the examination workpapers so that examination resources may instead be used to update the information while on-site at the insurer. Similar to the benefits of reviewing and using external or internal auditor workpapers, examiners use of detailed financial analysis workpapers in the examination files should result in examinations being more efficient and streamlined.

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Attachment Four

Proposed Revisions Related to Handbook Clean Up

- Section 1-1: Review and Reliance on Another State’s Workpapers (Coordination Plan)
- Exhibit E
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I. EXAMINATION OVERVIEW

This section of the Handbook addresses the following subjects:

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

E. Review and Reliance on Another State’s Workpapers

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

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

1) Lead State/Exam Facilitator conducting a fully coordinated group examination – When the group examination is conducted in this manner, the Lead State/Exam Facilitator is responsible for the overall quality of the work performed in support of the coordinated exam conclusions. Any work performed that is solely related to an individual domestic is excluded from the Lead State/Exam Facilitator’s responsibility. For a discussion of specific responsibilities of the Lead State/Exam Facilitator, refer to the “Responsibilities of the Lead State” and the “Responsibilities of the Exam Facilitator” sections above. Additionally, Exhibit Z, Part Two – Section A and/or Exhibit Z, Part Two – Section B should be completed in this scenario.

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

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

1. Obtain the external auditor’s engagement letter to ensure that there are no indemnification clauses or other unusual items included in the engagement letter.

**Guidance Point:** An indemnification clause between an insurer and an external auditor automatically breaches the independence of that auditor. If an indemnification clause exists, whether directly or indirectly, the examiner must evaluate whether it is reasonable to place reliance on the work of the external auditor. Additionally, the inclusion of an indemnification clause in a statutory auditing engagement letter is a breach of independence as outlined in the AICPA Ethics Interpretation 501-8.

2. If not already performed by the financial analyst, obtain the following correspondence as required by the NAIC Annual Financial Reporting Model Regulation. Evaluate the content of the correspondence for consideration in the planning phases of the examination.

   a. An “Awareness Letter” noting the external auditor’s understanding of the insurance codes and regulations applicable to the insurer and affirming that the opinion expressed on the financial statements is in terms of their conformity to the statutory accounting principles.

   b. If there was a change in auditor since the last examination, obtain the following documents:

      i. A “Notification Letter” from the insurer to the commissioner stating whether, in the 24 months preceding the change in auditor, there were any disagreements with the former auditor.

      ii. A “Confirmation Letter” from the former auditor stating whether they agree with the statements contained in the insurer’s “Notification Letter” and, if not, stating the reasons for which he or she does not agree.

   c. A “Qualification Letter” from the external auditor which includes the following representations:

      i. The auditor is independent.

      ii. The audit staff assigned to the engagement have sufficient background, designations and experience, in general, and the experience in audits of insurers.
iii. The auditor’s opinion will be filed in compliance with regulation.

iv. The auditor consents to make available for review all workpapers and communications obtained as part of the audit to the examiner.

v. The auditor is properly licensed by an appropriate state licensing authority and is a member in good standing with the AICPA.

vi. The auditor meets the qualifications of an Independent Certified Public Accountant as defined in Section 7 of the NAIC Annual Financial Reporting Model Regulation.

d. “Notification of Adverse Financial Condition,” if applicable, outlining the reasons for the classification of Adverse Financial Condition.

e. “Communication of Internal Control Related Matters Noted in an Audit,” which outlines any unremediated material weaknesses noted during the audit.

3. If not already performed by the financial analyst, obtain a copy of all recorded and unrecorded audit adjustments for the most recent year of the examination period (or multiple years of the examination period, if deemed necessary) each year since the last examination, along with supporting documentation regarding the adjustments or explanations from the external auditor. Evaluate the adjustments for consideration in the planning phases of the examination. 

**Guidance Point:** The examiner should use information regarding audit adjustments identified by the external auditor in identifying risks or internal control weaknesses. This consideration should be documented within the examiner’s workpapers.

4. If not already performed by the financial analyst, obtain a copy of the signed management representation letter for the most recent year of the examination period (or multiple years of the examination period, if deemed necessary) each year since the last examination, which acknowledges that management is responsible for the presentation of the financial statements and has considered all uncorrected misstatements and concluded that any uncorrected misstatements are immaterial, both individually and in the aggregate. (Practice Alert 94-1: Dealing with Audit Differences; SAS 89: Audit Adjustments)

a. Review the entire management representation letter to determine if there are any non-standard representations or representations that would have an impact on the examination.

5. If not already performed by the financial analyst, obtain a copy of the internal control-related matters presentation materials for the most recent year of the examination period (or multiple years of the examination period, if deemed necessary) each year since the last examination, including the Management Letter, prepared by the external auditor for the audit committee’s review. Verify that the presentation took place through review of audit committee meeting minutes. 

**Guidance Point:** The external auditor is required to provide written communication to the audit committee of all significant deficiencies or material weaknesses known by the external auditor. These comments from the external auditors should be a good guide as...
to what areas will need additional testwork.

6. If not already performed by the financial analyst, obtain from the external auditor a copy of the independent statutory audit report and opinion for the most recent year of the examination period (or multiple years of the examination period, if deemed necessary) each year since the last examination.

   a. Verify that the audit report has an unmodified audit opinion, except with regard to the use of prescribed or permitted practices related to statutory accounting in the insurer’s state of domicile. If an unmodified opinion was not issued, document the rationale for the modified opinion (e.g., qualified, adverse) and how this was considered during the examiner’s risk assessment process.

   b. Identify any issues (material findings, contingencies, subsequent events, etc.) that should be considered during the examination. Document any issues noted and how they were considered during the examiner’s risk assessment process.

   c. Ensure that the audited financial statements reconcile to the annual statement. If not, the examiner should ask the external auditor to provide an explanation for any differences.
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Attachment Five

2017 Project Listing
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<th>No.</th>
<th>Request/Issue to be addressed</th>
<th>Topic</th>
<th>Referral (If Applicable)</th>
<th>Progress</th>
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| 1   | Consider the need to add guidance on Principles-Based Reserving for life insurers.          | Principles-Based Reserving (PBR)                                      | PBR Review (EX) Working Group  
June 13, 2017 | Major updates were adopted in 2013 to help examiners discuss planning for implementation of PBR. More substantial revisions were exposed on 6/29/17 conference call. Consider for adoption on 9/27/17 conference call. |
| 2   | Revise definition of the credit risk and operational risk branded risk classifications.    | Branded Risk Classification Definitions Risk-Focused Surveillance (E) Working Group  
| 3   | Consider referencing the ORSA Information Sharing Best Practices Guide in the Handbook in order to promote effective sharing and protect the confidentiality of the ORSA reports in coordinated states. | ORSA Information Sharing Best Practices | ORSA Implementation (E) Working Group  
December 1, 2016 |  | Adopted on 6/29/17 conference call.                                    |
| 4   | Develop a regulator tool to encourage uniformity and consistency in reviewing corporate governance practices across regulatory functions. This is a long-term project that will be considered at a later date, once more states have adopted the CGAD. | Consistency and Uniformity Among States in Assessing Corporate Governance | Corporate Governance (E) Working Group  
April 7, 2013  
Financial Condition (E) Committee  
April 5, 2016 | N/A at this time.                                                               |
April 4, 2016 | Ongoing.                                                                  |
| 6   | Consider whether guidance should be revised to address issues related to run-off exams, corporate governance, re-domestication and expansion of business. | Enhanced Regulatory Guidance | Financial Analysis (E) Working Group  
| 7   | Incorporate a review of necessary provisions (per Holding Company Model) into Handbook.   | Affiliated Agreements Receivership Model Law (E) Working Group  
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<th>Topic</th>
<th>Referral (If Applicable)</th>
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<td>8 Communication with Analyst</td>
<td>N/A</td>
<td>Proposed revisions to Exhibit A to clarify that the meeting between the examiner in analyst during planning should occur in person or via conference call. Email is not sufficient. Proposed revisions to Exhibit B to provide instructions for the company completing the questionnaire - allows for the company to note that a requested item has already been provided, including when and to whom. As part of this, a recommendation was provided to F Committee to ensure that the related accreditation review team guidelines match Handbook guidance in this area.</td>
<td>Exposed revisions to Exhibit A and Exhibit B on 6/29/17 conference call. Consider for adoption on 9/27/17 conference call.</td>
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<td>Annual Maintenance</td>
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<td>2 Handbook Cleanup</td>
<td>On an annual basis, consider revisions to the Handbook to ensure consistency of guidance. Allow for feedback through the use of a “Proposal Submission Form”.</td>
<td>Clarify that Exhibit Z, Part 2D should be completed by any state part of a holding company group that did not participate in a coordinated exam. Clarify that support should be obtained for most current year of exam period, with consideration of obtaining historical years if warranted. Consider exposure of proposed revisions on 9/27/17 conference call.</td>
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