

MODEL LAW ON EXAMINATIONS

Table of Contents

Prefatory Drafting Comment	
Section 1.	Purpose
Section 2.	Definitions
Section 3.	Authority, Scope and Scheduling of Examinations
Section 4.	Conduct of Examinations
Section 5.	Examination Reports
Section 6.	Conflict of Interest
Section 7.	Cost of Examinations
Section 8.	Immunity from Liability

Prefatory Drafting Comment

This model act reflects a conceptual change with respect to the frequency and scope of on-site financial examinations of insurers. The Act authorizes the commissioner to conduct examinations whenever it is deemed necessary and the commissioner is given the flexibility to decide the scope of the examination. Since criteria for determining when a company should be examined and the scope of that examination and procedures to be employed is a complex matter, the Act requires the commissioner to observe the direction set forth in the *NAIC Examiner's Handbook* with respect to these matters.

The objective of the model act is to direct department resources to companies having or likely to have financial difficulty; however, all companies are required to be examined once every five years, although the scope and extent of that exam will be based on the particular attributes of the company to be examined.

The conceptual change reflected by this model law can be accomplished because over the last several years a variety of additional financial regulatory tools have been developed and implemented including annual independent CPA audits, opinions on insurance reserves by qualified actuaries, annual financial statement analyses and others which alleviate the necessity for comprehensive periodic examinations.

This model act will not diminish the commissioner's authority to conduct examinations but rather will see that examinations are a more effective part of the department financial regulation and surveillance program.

Section 1. Purpose

The purpose of this Act is to provide an effective and efficient system for examining the activities, operations, financial condition and affairs of all persons transacting the business of insurance in this state and all persons otherwise subject to the jurisdiction of the commissioner. The provisions of the Act are intended to enable the commissioner to adopt a flexible system of examinations that directs resources as may be deemed appropriate and necessary for the administration of the insurance and insurance related laws of this state.

Section 2. Definitions

The following terms as used in this Act shall have the respective meanings hereinafter set forth:

- A. "Commissioner" means the commissioner of insurance of this state.

Drafting Note: The title of the chief insurance regulatory official should be used here and throughout the law.

- B. "Company" means a person engaging in or proposing or attempting to engage in any transaction or kind of insurance or surety business and any person or group of persons who may otherwise be subject to the administrative, regulatory or taxing authority of the commissioner.
- C. "Department" means the department of insurance of this state.
- D. "Examiner" means an individual or firm having been authorized by the commissioner to conduct an examination under this Act.
- E. "Insurer" means [refer to appropriate definition in state insurance code].
- F. "Person" means an individual, aggregation of individuals, trust, association, partnership or corporation, or any affiliate thereof.

Section 3. Authority, Scope and Scheduling of Examinations

- A. The commissioner or any of the commissioner's examiners may conduct an examination under this Act of any company as often as the commissioner in his or her sole discretion deems appropriate but shall at a minimum, conduct an examination of every insurer licensed in this state not less frequently than once every five (5) years. In scheduling and determining the nature, scope and frequency of the examinations, the commissioner shall consider such matters as the results of financial statement analyses and ratios, changes in management or ownership, actuarial opinions, reports of independent Certified Public Accountants and other criteria as set forth in the *Examiners' Handbook* adopted by the National Association of Insurance Commissioners and in effect when the commissioner exercises discretion under this section.
- B. For purposes of completing an examination of a company under this Act, the commissioner may examine or investigate any person, or the business of any person, in so far as the examination or investigation is, in the sole discretion of the commissioner, necessary or material to the examination of the company.

Drafting Note: In order to force a person outside the state to cooperate with any examination, it may be necessary to obtain judicial enforcement of a subpoena.

- C. In lieu of an examination under this Act of a foreign or alien insurer licensed in this state, the commissioner may accept an examination report on the company as prepared by the insurance department for the company's state of domicile or port-of-entry state until January 1, 1994. Thereafter, such reports may only be accepted if (1), the insurance department was at the time of the examination accredited under the National Association of Insurance Commissioners' Financial Regulation Standards and Accreditation Program or (2) the examination is performed under the supervision of an accredited insurance department or with the participation of one or more examiners who are employed by an accredited state insurance department and who, after a review of the examination work papers and report, state under oath that the examination was performed in a manner consistent with the standards and procedures required by their insurance department.

Section 4. Conduct of Examinations

- A. Upon determining that an examination should be conducted, the commissioner or the commissioner's designee shall issue an examination warrant appointing one or more examiners to perform the examination and instructing them as to the scope of the examination. In conducting the examination, the examiner shall observe those guidelines and procedures set forth in the *Examiners' Handbook* adopted by the National Association of Insurance Commissioners. The commissioner may also employ such other guidelines or procedures as the commissioner may deem appropriate.
- B. Every company or person from whom information is sought, its officers, directors and agents shall provide to the examiners appointed under Subsection A timely, convenient and free access at all reasonable hours at its offices to all books, records, accounts, papers, documents and any or all computer or other recordings relating to the property, assets, business and affairs of the company being examined. The officers, directors, employees and agents of the company or person must facilitate the examination and aid in the examination so far as it is in their power to do so. The refusal of a company, by its officers, directors, employees or agents, to submit to examination or to comply with any reasonable written request of the examiners shall be grounds for suspension or refusal of, or nonrenewal of any license or authority held by the company to engage in an insurance or other business subject to the commissioner's jurisdiction. Any such proceedings for suspension, revocation or refusal of a license or authority shall be conducted pursuant to Section [insert reference to cease and desist statute or other law having a post-order hearing mechanism].
- C. The commissioner or any of the commissioner's examiners shall have the power to issue subpoenas, to administer oaths and to examine under oath any person as to any matter pertinent to the examination. Upon the failure or refusal of a person to obey a subpoena, the commissioner may petition a court of competent jurisdiction, and upon proper showing, the court may enter an order compelling the witness to appear and testify or produce documentary evidence. Failure to obey the court order shall be punishable as contempt of court. [or "Such subpoenas may be enforced pursuant to the provisions of Section _____ of this Code."]
- D. When making an examination under this Act, the commissioner may retain attorneys, appraisers, independent actuaries, independent certified public accountants or other professionals and specialists as examiners, the cost of which shall be borne by the company that is the subject of the examination.
- E. Nothing contained in this Act shall be construed to limit the commissioner's authority to terminate or suspend an examination in order to pursue other legal or regulatory action pursuant to the insurance laws of this state. Findings of fact and conclusions made pursuant to an examination shall be prima facie evidence in any legal or regulatory action.
- F. Nothing contained in this Act shall be construed to limit the commissioner's authority to use and, if appropriate, to make public any final or preliminary examination report, any examiner or company workpapers or other documents, or any other information discovered or developed during the course of an examination in the furtherance of any legal or regulatory action that the commissioner may, in his or her sole discretion, deem appropriate.

Section 5. Examination Reports

A. General Description

An examination report shall be comprised of only facts appearing upon the books, records or other documents of the company, its agents or other persons examined, or as ascertained from the testimony of its officers or agents or other persons examined concerning its affairs, and such conclusions and recommendations as the examiners find reasonably warranted from the facts.

B. Filing of Examination Report

No later than sixty (60) days following completion of the examination, the examiner in charge shall file with the department a verified written report of examination under oath. Upon receipt of the verified report, the department shall transmit the report to the company examined, together with a notice that shall afford the company examined a reasonable opportunity of not more than thirty (30) days to make a written submission or rebuttal with respect to any matters contained in the examination report.

C. Adoption of Report on Examination

Within thirty (30) days of the end of the period allowed for the receipt of written submissions or rebuttals, the commissioner shall fully consider and review the report, together with any written submissions or rebuttals and any relevant portions of the examiner's workpapers and enter an order:

- (1) Adopting the examination report as filed or with modification or corrections. If the examination report reveals that the company is operating in violation of any law, regulation or prior order of the commissioner, the commissioner may order the company to take any action the commissioner considers necessary and appropriate to cure the violation; or
- (2) Rejecting the examination report with directions to the examiners to reopen the examination for purposes of obtaining additional data, documentation or information, and refile pursuant to Subsection A above; or
- (3) Calling for an investigatory hearing with no less than twenty (20) days notice to the company for purposes of obtaining additional documentation, data, information and testimony.

D. Orders and Procedures

- (1) Orders entered pursuant to Subsection C(1) above shall be accompanied by findings and conclusions resulting from the commissioner's consideration and review of the examination report, relevant examiner workpapers and any written submissions or rebuttals. An order shall be considered a final administrative decision and may be appealed pursuant to the [insert name of State Administrative Review Law], and shall be served upon the company by certified mail, together with a copy of the adopted examination report. Within thirty (30) days of the issuance of the adopted report, the company shall file affidavits executed by each of its directors stating under oath that they have received a copy of the adopted report and related orders.

- (2) A hearing conducted under Subsection C(3) above by the commissioner or authorized representative shall be conducted as a nonadversarial confidential investigatory proceeding as necessary for the resolution of any inconsistencies, discrepancies or disputed issues apparent upon the face of the filed examination report or raised by or as a result of the commissioner's review of relevant workpapers or by the written submission or rebuttal of the company. Within twenty (20) days of the conclusion of any such hearing, the commissioner shall enter an order pursuant to Subsection C(1) above.
 - (a) The commissioner shall not appoint an examiner as an authorized representative to conduct the hearing. The hearing shall proceed expeditiously with discovery by the company limited to the examiner's workpapers that tend to substantiate any assertions set forth in any written submission or rebuttal. The commissioner or the commissioner's representative may issue subpoenas for the attendance of any witnesses or the production of any documents deemed relevant to the investigation whether under the control of the department, the company or other persons. The documents produced shall be included in the record and testimony taken by the commissioner or the commissioner's representative shall be under oath and preserved for the record. Nothing contained in this section shall require the department to disclose any information or records that would indicate or show the existence or content of any investigation or activity of a criminal justice agency.
 - (b) The hearing shall proceed with the commissioner or the commissioner's representative posing questions to the persons subpoenaed. Thereafter the company and the department may present testimony relevant to the investigation. Cross examination shall be conducted only by the commissioner or the commissioner's representative. The company and the department shall be permitted to make closing statements and may be represented by counsel of their choice.

E. Publication and Use

- (1) Upon the adoption of the examination report under Subsection C(1) above, the commissioner shall continue to hold the content of the examination report as private and confidential information for a period of [insert number] days except to the extent provided in Subsection B. Thereafter, the commissioner may open the report for public inspection so long as no court of competent jurisdiction has stayed its publication.

Drafting Note: The time period may correspond to the amount of time allowed for a party to seek administrative review under state law or it should at a minimum allow a company adequate time, not less than two (2) days following receipt of the adopted report to obtain an equitable stay if provided for under state law.

- (2) Nothing contained in this Code shall prevent or be construed as prohibiting the commissioner from disclosing the content of an examination report, preliminary examination report or results, or any matter relating thereto, to the insurance department of this or any other state or country, or to law enforcement officials of this or any other state or agency of the federal government at any time, so long as the agency or office receiving the report or matters relating thereto agrees in writing to hold it confidential and in a manner consistent with this Act.

- (3) In the event the commissioner determines that regulatory action is appropriate as a result of an examination, he or she may initiate any proceedings or actions provided by law.

F. Privilege for, and Confidentiality of Ancillary Information

- (1)
 - (a) Except as provided in Subsection E above and in this subsection, documents, materials or other information, including, but not limited to, all working papers, and copies thereof, created, produced or obtained by or disclosed to the commissioner or any other person in the course of an examination made under this Act, or in the course of analysis by the commissioner of the financial condition or market conduct of a company shall be confidential by law and privileged, shall not be subject to [insert open records, freedom of information, sunshine or other appropriate phrase], shall not be subject to subpoena, and shall not be subject to discovery or admissible in evidence in any private civil action. The commissioner is authorized to use the documents, materials or other information in the furtherance of any regulatory or legal action brought as part of the commissioner's official duties.
 - (b) Documents, materials or other information, including, but not limited to, all working papers, and copies thereof, in the possession or control of the National Association of Insurance Commissioners and its affiliates and subsidiaries shall be confidential by law and privileged, shall not be subject to subpoena, and shall not be subject to discovery or admissible in evidence in any private civil action if they are:
 - (i) Created, produced or obtained by or disclosed to the National Association of Insurance Commissioners and its affiliates and subsidiaries in the course of the National Association of Insurance Commissioners and its affiliates and subsidiaries assisting an examination made under this Act, or assisting a commissioner in the analysis of the financial condition or market conduct of a company; or
 - (ii) Disclosed to the National Association of Insurance Commissioners and its affiliates and subsidiaries under Paragraph (3) of this subsection by a commissioner.
 - (c) For the purposes of Paragraph (1)(b), "Act" includes the law of another state or jurisdiction that is substantially similar to this Act.
- (2) Neither the commissioner nor any person who received the documents, material or other information while acting under the authority of the commissioner, including the National Association of Insurance Commissioners and its affiliates and subsidiaries, shall be permitted to testify in any private civil action concerning any confidential documents, materials or information subject to Paragraph (1).

- (3) In order to assist in the performance of the commissioner's duties, the commissioner:
- (a) May share documents, materials or other information, including the confidential and privileged documents, materials or information subject to Paragraph (1), with other state, federal and international regulatory agencies, with the National Association of Insurance Commissioners and its affiliates and subsidiaries, and with state, federal and international law enforcement authorities, provided that the recipient agrees to maintain the confidentiality and privileged status of the document, material, communication or other information;
 - (b) May receive documents, materials, communications or information, including otherwise confidential and privileged documents, materials or information, from the National Association of Insurance Commissioners and its affiliates and subsidiaries, and from regulatory and law enforcement officials of other foreign or domestic jurisdictions, and shall maintain as confidential or privileged any document, material or information received with notice or the understanding that it is confidential or privileged under the laws of the jurisdiction that is the source of the document, material or information; and
 - (c) [Optional provision] May enter into agreements governing sharing and use of information consistent with this subsection.

Drafting Note: Subsection F(3)(a) assumes that the recipient has the authority to protect the applicable confidentiality or privilege, but does not address the verification of that authority, which would presumably occur in the context of a broader information sharing agreement.

- (4) No waiver of any applicable privilege or claim of confidentiality in the documents, materials or information shall occur as a result of disclosure to the commissioner under this section or as a result of sharing as authorized in Paragraph (3).
- (5) A privilege established under the law of any state or jurisdiction that is substantially similar to the privilege established under this subsection shall be available and enforced in any proceeding in, and in any court of, this state.
- (6) In this subsection "department," "insurance department," "law enforcement agency," "regulatory agency," and the "National Association of Insurance Commissioners" include, but are not limited to, their employees, agents, consultants and contractors.

Section 6. Conflict of Interest

- A. An examiner may not be appointed by the commissioner if the examiner, either directly or indirectly, has a conflict of interest or is affiliated with the management of or owns a pecuniary interest in any person subject to examination under this Act. This section shall not be construed to automatically preclude an examiner from being:
- (1) A policyholder or claimant under an insurance policy;
 - (2) A grantor of a mortgage or similar instrument on the examiner's residence to a regulated entity if done under customary terms and in the ordinary course of business;

- (3) An investment owner in shares of regulated diversified investment companies; or
 - (4) A settlor or beneficiary of a “blind trust” into which any otherwise impermissible holdings have been placed.
- B. Notwithstanding the requirements of this section, the commissioner may retain from time to time, on an individual basis, qualified actuaries, certified public accountants, or other similar individuals who are independently practicing their professions, even though these persons may from time to time be similarly employed or retained by persons subject to examination under this Act.

Section 7. Cost of Examinations

Drafting Comment: The NAIC Model State Insurance Department Funding Bill or such funding mechanism as may be currently authorized by law should be incorporated here by reference. Any funding mechanism should assure that the manner in which examinations are funded does not influence the scheduling, scope or conduct of examination.

Section 8. Immunity from Liability

- A. No cause of action shall arise nor shall any liability be imposed against the commissioner, the commissioner’s authorized representatives or an examiner appointed by the commissioner for any statements made or conduct performed in good faith while carrying out the provisions of this Act.
- B. No cause of action shall arise, nor shall any liability be imposed against any person for the act of communicating or delivering information or data to the commissioner or the commissioner’s authorized representative or examiner pursuant to an examination made under this Act, if the act of communication or delivery was performed in good faith and without fraudulent intent or the intent to deceive.
- C. This section does not abrogate or modify in any way any common law or statutory privilege or immunity heretofore enjoyed by any person identified in Subsection A.
- D. A person identified in Subsection A shall be entitled to an award of attorney’s fees and costs if he or she is the prevailing party in a civil cause of action for libel, slander or any other relevant tort arising out of activities in carrying out the provisions of this Act and the party bringing the action was not substantially justified in doing so. For purposes of this section a proceeding is “substantially justified” if it had a reasonable basis in law or fact at the time that it was initiated.

Chronological Summary of Action (all references are to the Proceedings of the NAIC).

1991 Proc. I 9, 14, 26, 27-31 (adopted).

1999 Proc. 4th Quarter 15, 364, 369, 370-372 (amended).

*This replaces an earlier model law entitled: Standard Law Relating to Procedures in Examining the Affairs of Insurance Companies
1956 Proc. II 328, 329-333 (adopted).*