FINANCIAL EXAMINERS HANDBOOK (E) TECHNICAL GROUP
Conference Call
Monday, October 5, 202020
2:00 p.m. ET/ 1:00 p.m. CT

ROLL CALL

Susan Bernard, Chair	California	Justin Schrader	Nebraska
John Litweiler, Vice Chair	Wisconsin	Joel Bengo/Peter Rao	Nevada
Richard Ford	Alabama	Colin Wilkins	New Hampshire
William Arfanis	Connecticut	John Sirovetz	New Jersey
N. Kevin Brown	District of Columbia	Tracy Snow	Ohio
Cindy Andersen	Illinois	Eli Snowbarger	Oklahoma
Grace Kelly	Minnesota	Melissa Greiner	Pennsylvania
Levi Nwasoria	Missouri	John Jacobson	Washington
NAIC Support Staff: Bailey Henning			

AGENDA

1. Consider Exposure of Handbook Guidance—*Susan Bernard (CA)*
   - Revisions to Incorporate Consideration of Reciprocal Jurisdiction Reinsurers — Attachment One
   - Revisions to Incorporate Various Reserve-Related Guidance — Attachment Two

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

3. Adjournment

Attachment One

Section 1, Part V: Reinsurance Review

Proposed revisions to incorporate the concept of Reciprocal Jurisdiction Reinsurers and related changes to *Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786)*

V. REINSURANCE REVIEW

This section of the Handbook addresses the following subjects:

A. Evaluation of Risk Transfer
B. Credit for Reinsurance Guidelines
C. Reinsurance Balances Recoverable
D. Termination of Reinsurance Agreements

---Detail Eliminated to Conserve Space--

B. Credit for Reinsurance Guidelines

Note: In ~~late 2011~~2019, the NAIC adopted revisions to the Credit for Reinsurance Model Law (#785) and the Credit for Reinsurance Model Regulation (#786). These revisions serve to extend the ability for U.S. ceding insurers to obtain credit for reinsurance for reinsurance ceded to reinsurers from Reciprocal Jurisdictions with no collateral requirements. ~~reduce reinsurance collateral requirements for reinsurers that have been "certified" by the domestic state of the ceding insurer. A number of states have adopted these revisions within their respective credit for reinsurance statute and/or regulation, and several additional states are considering similar proposals.~~ If your state has adopted these revisions, you should refer to the model or your state's updated statute for the most current guidance regarding credit for reinsurance as it pertains to "Reciprocal Jurisdictions". ~~"certified reinsurers."~~

Subject to the laws of the various states, credit for reinsurance may be allowed to the ceding company when the reinsurance contract includes a proper insolvency clause and the specific criteria for the appropriate category have been adequately met:

1. Reinsurer is Licensed in the Ceding Company's Domiciliary State

   Reinsurers who meet this classification must have obtained their licensure status at the time the statutory financial statement credit for reinsurance is claimed or when financial statements indicating the credit have been filed by the ceding company. The reinsurer then must continue to maintain compliance with the licensure status at all times after the credit has been taken. The licensure requirement is considered to be perpetual and not periodic; therefore, appropriate information is required to be included in the company's financial statements when reinsurers do not comply with the requirements.

2. Assuming Insurer Has Obtained Reinsurer Accreditation

   An assuming insurer must have obtained reinsurance accreditation in the domiciliary state of the ceding company at the time the financial statement credit is claimed in order for the domestic insurer to receive a credit for reinsurance. In order to obtain the status of an accredited reinsurer, the assuming company must file a Form AR-1 (Certificate of Assuming Insurer), which grants specific authority to the ceding company's domiciliary insurance commissioner (Part Two of Exhibit N – Reinsurance Review), as well as documentation of licensure to transact insurance or reinsurance and annual statements with the domiciliary insurance commissioner. In addition, the assuming insurer must demonstrate to the satisfaction of the commissioner that it has adequate financial capacity to meet its reinsurance obligations and is otherwise qualified to assume reinsurance from domestic insurers. An assuming insurer is deemed to meet this requirement as of the time of its application if it maintains a surplus as regards policyholders in an amount not less than $20 million and its accreditation has not been denied by the commissioner within ninety (90) days after submission of its application. The insurance commissioner is entitled to suspend or revoke reinsurer accreditation if the above conditions are not preserved.

3. Reinsurer is Domiciled in Another State

   The reinsurer must be domiciled (and licensed) in a substantially similar state that has adopted the NAIC *Credit for Reinsurance Model Law* (#785) or substantially similar law and, therefore, is subject to that state's credit for reinsurance standards at the time the financial statement credit for reinsurance is claimed. The reinsurer must also maintain a surplus of at least $20 million and file a Form AR-1 with the insurance commissioner.

4. Reinsurer Maintains Trust Funds

A credit for reinsurance ceded by domestic insurers is available to assuming insurers that maintain trust funds for a requisite amount in a qualified U.S. financial institution (actual amount is determined by the classification of the assuming insurer). The assuming insurer is required to annually report to the insurance commissioner for determination of the sufficiency of the trust fund. The classifications of assuming insurers are as follows:

a. Single Assuming Insurer – Trust funds must equal or exceed the assuming insurer's liabilities attributable to ceded reinsurance by U.S. domiciled insurers. In addition, the assuming insurer shall maintain trusteed surplus of at least $20 million. If the assuming insurer has permanently discontinued underwriting new business secured by the trust for at least three full years, the commissioner may authorize a reduced required trusteed surplus to an amount no lower than thirty percent (30%) of the assuming insurer's liabilities attributable to reinsurance ceded by the U.S. ceding insurers covered by the trust.

b. Incorporated and Unincorporated Group Underwriters – For reinsurance ceded under reinsurance agreements dated after January 1, 1992, trust funds must equal or exceed the group's liabilities for business ceded by U.S. domiciled ceding insurers. For reinsurance agreements dated before December 31, 1992, trust funds must at least equal the insurance and reinsurance liabilities attributable to business written in the United States. In addition to these trusts, the underwriters must maintain $100 million in surplus for the benefit of U.S.-domiciled ceding insurers. The incorporated members of the group are prohibited from engaging in auxiliary business, other than underwriting as a member of the group, and must be subject to the same regulation and control of the group as the unincorporated members. The group is also required to annually file either a certification of solvency for each underwriter member or independently prepared financial statements for each underwriter to the insurance commissioner.

A credit for reinsurance will not be granted for reinsurers who maintain trust funds, unless the insurance commissioner of the state where the trust is domiciled has approved the form of the trust. An insurance commissioner from another state may approve the trust if the commissioner has accepted responsibility for the regulatory oversight of the trust. The form of the trust is required to be filed with the insurance commissioner in every state the ceding insurer beneficiaries of the trust are domiciled.

5. Certified Reinsurers

An assuming reinsurer must have obtained certification by the commissioner of the domiciliary state of the ceding company at the time the financial statement credit is claimed in order for the domestic insurer to receive a credit for reinsurance. In order to obtain the status of certified reinsurer, the assuming reinsurer must be domiciled and licensed to transact insurance or reinsurance in a qualified jurisdiction, as determined by the commissioner. The assuming reinsurer must also maintain a surplus level of no less than $250 million and maintain financial strength ratings from two or more acceptable rating agencies.

The allowable credit for reinsurance ceded by a domestic insurer to an assuming reinsurer that has been certified as a reinsurer in the domestic insurer's state is based upon the security held by, or on behalf of, the ceding insurer (e.g., amount of funds held, letter of credit, etc.). The amount of security required to be held (e.g., level of collateral required) corresponds to the rating assigned to the certified reinsurer by the commissioner, which is based on various factors including, but not limited to, the certified reinsurer's business practices, regulatory actions against the certified reinsurer, financial strength and the report of the independent auditor.

6. Reciprocal Jurisdiction Reinsurers

Credit for reinsurance ceded by domestic insurers is available to an assuming insurer that is licensed to write reinusrance by, and has its head office or is domiciled in, a Reciprocal Jurisdiction. For reinsurance with

Reciprocal Jurisdiction Reinsurers there are no collateral requirements if the reinsurers have met the minimum standards in the *Credit for Reinsurance Model Law* (#785) and the *Credit for Reinsurance Model Regulation* (#786). In order to be designiated a Reciprocal Jurisdiction by the Commissioner, a jurisdiction must meet one of the following requirements: 1) a non-U.S. jurisdiction that is subject to an in-force covered agreement with the United States, 2) meets the requirements for accreditation under the NAIC financial standards and accreditation program, or 3) a qualified jurisdiction, as determined by the commissioner. The assuming insurer must also maintain a surplus level of no less than $250 million and a minimum RBC ratio 300%, or amounts established by Model #785 and Model #786.

Attachment Two

Proposed revisions within this attachment are the result of various workstreams but affect many of the same sections of guidance. For ease of presentation, the revisions are shown together.

Workstream	Affected Sections	Page #
Annual Repository Maintenance	Health Reserves Repository P&C Reserves Repository Life Reserves Repository Section 1, Part VI	7-21 22-36 37-51 55-63
Updates to incorporate consideration of LTCI	Life Reserves Repository Underwriting Repository Section 1, Part VI Exhibit Y – Chief Actuary Interview	44-45 52-54 60-63 65-66
Updates related to input received from AOWG/CASTF	P&C Reserves Repository Exhibit M – Corporate Governance	31-32 64

EXAMINATION REPOSITORY – RESERVES/CLAIMS HANDLING (HEALTH)

Annual Statement Blank Line Items

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

Claims Unpaid (Less Reinsurance Ceded)
Accrued Medical Incentive Pool and Bonus Payments
Unpaid Claims Adjustment Expenses
Aggregate Health Policy Reserves
Premium Deficiency Reserves
Aggregate Life Policy Reserves
Unearned Premium Reserves
~~Aggregate Claim Reserves~~
Aggregate Health Claim Reserves

Relevant Statements of Statutory Accounting Principles (SSAPs)

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

~~No. 3 Accounting Changes and Corrections of Errors~~
No. 5R Liabilities, Contingencies and Impairments of Assets – Revised
~~No. 25 Affiliates and Other Related Parties~~
No. 50 Classifications of Insurance or Managed Care Contracts
No. 54R Individual and Group Accident and Health Contracts
No. 55 Unpaid Claims, Losses and Loss Adjustment Expenses
No. 61R Life, Deposit-Type and Accident and Health Reinsurance – Revised
No. 66 Retrospectively Rated Contracts
No. 107 Risk-Sharing Provisions of the Affordable Care Act

Identified Risk	Branded Risk	Exam Asrt.	Critical Risks	Possible Controls	Possible Test of Controls	Possible Detail Tests
Other Than Financial Reporting Risks						
The board of directors (or committee thereof) is not involved in establishing and/or reviewing the insurer's overall reserving practices.	OP ST RV	Other	RA	The insurer's board of directors (or committee thereof) has adopted and/or reviewed the insurer's overall reserving practices. The board of directors (or committee thereof) regularly discusses reserving issues and receives reports from the appointed actuary. The 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.	Verify that the insurer has established overall reserving practices that have been adopted and/or reviewed by the board of directors (or committee thereof). Review board of directors (or committee thereof) minutes to ensure discussion of reserving. Review meeting materials to determine if materials would properly facilitate BOD oversight. Obtain information on revisions made by the insurer to its reserving practices and verify whether they were appropriately reviewed and/or approved by the board of directors (or committee thereof).	Obtain information on the insurer's overall reserving practices, including meeting materials, and forward it to the insurance department actuary or an independent actuary for review. Discuss with members of the board of directors (or committee thereof) their level of involvement in the monitoring of reserving practices.
Financial Reporting Risks						
New claims are not entered into the claims management system.	RP LG	AC CT CO	RD	Segregation of duties exists between the claim notification and the input of claims data into the claims system. Control reports exist to	Observe that segregation of duties exists between the claim notification and the input of claims data into the claims system. Obtain the exception report	Select a sample of items from the exception reports and verify that the claim was appropriately accounted for.* Select a sample of claim

Identified Risk	Branded Risk	Exam Asrt.	Critical Risks	Possible Controls	Possible Test of Controls	Possible Detail Tests
				ensure all claims reported to the insurer electronically or manually have been entered into the claims system. Exceptions are identified and resolved timely. The insurer reviews the Type II SOC 1 reports and ensures compliance with user-control considerations for any outsourcing companies that enter claims on behalf of the insurer.	and ensure management review and resolution of any exceptions. Test the operating effectiveness of the automated claims posting process through reperformance and observation, which could include IT testing of batch totals to ensure completeness of transactions processed. Obtain documentation of management's review of the Type II SOC 1 reports.	and expense payments made subsequent to year-end to verify that claims were recorded in the proper period. Review Type II SOC 1 reports, including bridge letters, to ensure there are no significant control deficiencies or internal control weaknesses related to processing new claims into the claims system.
Claims data is incomplete or incorrectly entered into the claims management system.	OP LG	AC CT CO EX	RD	Claims data is subject to independent verification or quality assurance (QA) reviews. The claims system has automated controls that will not allow a claim to be entered without a valid in-force policy. The claims system has automated controls that will not permit continued	Obtain documentation of independent claim verification or QA review. Ensure reviews performed address the completeness and accuracy of underlying claims information entered into the system. Test the operating effectiveness of automated controls (i.e., edit checks) through reperformance and observation. Obtain the error report and ensure proper resolution of exceptions.	Perform data validation tests to verify the accuracy of claim information maintained in the claims system, such as coverage terms, demographic data, date of service, provider name, service description or code, insured name, claim number and coverage period by vouching the information to the claimant's insurance contract, claims form and any other underlying support.* Scan the database(s) for internal inconsistencies,

Identified Risk	Branded Risk	Exam Asrt.	Critical Risks	Possible Controls	Possible Test of Controls	Possible Detail Tests
				processing until all pertinent claim data has been entered. Entering a valid policy number will automatically populate select policy data. System edits will identify data that does not meet the predetermined criteria, resulting in inclusion on a system-generated exception report. Segregation of duties exists between individuals responsible for new claim set-up and those responsible for setting up new policies.	Test the operating effectiveness of authority restrictions through reperformance and observation. Obtain claims set-up and new policy set-up authorization listings and cross-reference the listings to ensure that there are no employees with conflicting authority.	such as missing claim amounts, unusually small amounts and claims misclassified by type (e.g., Medicare). In situations where adequate segregation of duties is not apparent, obtain data to determine whether any claims were set up by the same user who created the corresponding policy in the master file. If any instances are identified, investigate the claim to ensure the claim exists and is supported by underlying data.
The third-party administrators (TPAs), or managing general agents (MGAs), are not processing claims in accordance with the insurer's claims procedures as outlined in the TPA agreement.	LG OP RP	AC CM	RD	The insurer performs regular audits of its TPAs/MGAs to determine whether insurer claims handling standards and additional contract provisions are being consistently followed by the TPA. Management obtains a Type II SOC 1 report for all TPAs and reviews the report to verify whether the TPA has adequate controls and that the insurer is adhering to user control considerations. Management performs necessary reviews to comply with applicable	Review audit reports and other documentation to determine whether the insurer provides sufficient oversight of its TPAs/MGAs. Verify that the insurer has obtained and reviewed the TPA's Type II SOC 1 report, if available. Determine whether the insurer is adhering to user control considerations. Obtain evidence of management's review of compliance with applicable	Determine, by a review of selected claims, whether the insurer is settling its claims accurately and in accordance with the contract, based on information contained in the claim file.* Review the Type II SOC 1 report to determine whether the controls outlined in the report are adequate to ensure that claims are being processed in accordance with the TPA agreement. Test for compliance with applicable state MGA regulations.

Identified Risk	Branded Risk	Exam Asrt.	Critical Risks	Possible Controls	Possible Test of Controls	Possible Detail Tests
				state MGA regulations.	state MGA regulations.	
Claims are not being processed accurately and in accordance with insurer guidelines.	OP ST LG	AC CM CO	RD	The insurer has administrative policies and maintains a claims procedures manual that outlines the following requirements: • Maximum benefit to be paid based on procedure type. • Usual, customary and reasonable (UCR) limitations. • Proper application of deductibles. • Reserving and payment authority and approval levels. • File documentation and tracking. • Procedures for handling suspicious and/or fraudulent claims. • Compliance with applicable state fair claims practices laws and/or regulations. Automated controls are in place to ensure that paid losses are not to exceed policy limits, cover ineligible loss causes/types and/or apply to a policy period for which insurer is not contractually responsible. Any consideration to pay a loss must be processed in	Review the claims procedures manual to determine its appropriateness, including management approval. Test the operating effectiveness of system edit checks to ensure procedures are implemented through reperformance and observation. Review assessments of the claims handling process performed by internal/external auditors,	Perform tests to determine whether claims were accurately processed in accordance with the claims procedures manual, approved authority limits and administrative policies through review of the claimant's insurance contract, claims form and any other underlying support. Review policyholder complaints and investigate significant issues. Review a sample of denied claims to ensure compliance with contract provisions.*

Identified Risk	**Branded Risk**	**Exam Asrt.**	**Critical Risks**	**Possible Controls**	**Possible Test of Controls**	**Possible Detail Tests**
				accordance with the insurer's procedures. As part of the claims processing procedures, the insurer obtains adequate documentation and coverage of benefits before a claim is settled. Claims approval is subject to approved authority limits. A QA review is periodically performed for each claims processor to ensure compliance with the claims handling policies.	reinsurers and/or others for significant issues. Test the operating effectiveness of controls to ensure adequate documentation is obtained before payment is made. Test the controls in place to ensure that claims are approved in accordance with documented authority limits. Review documentation of QA reviews to determine that the QA function is being executed as outlined in the insurer's policies. On a sample basis, reperform the QA testing to ensure that the testing was completed accurately.	
The claims data utilized by the actuary to estimate reserves does not correspond to the data in the insurer's claims system and to the data in the insurer's accounting records.	OP RV	AC CO	RD	The insurer has established procedures to reconcile actuarial data to the insurer's claims system, the data in the insurer's accounting records and appropriate annual financial statement schedules and/or exhibits. Such reconciliations are reviewed by supervisory personnel. Inventories of reported and unpaid claims are maintained and periodically	Review the insurer's reconciliation reports of actuarial data to the insurer's claims system and the insurer's accounting records. Ensure evidence of supervisory review. Review the insurer's reconciliation of reported and unpaid claims to the	Test reconciling items within the reconciliations for appropriateness. Reconcile the insurer's actuarial report for claims paid and claims adjustment expenses (CAE) to supporting insurer reports, general ledger and annual financial statement schedules and exhibits as of the valuation date.

Identified Risk	Branded Risk	Exam Asrt.	Critical Risks	Possible Controls	Possible Test of Controls	Possible Detail Tests
				reconciled to the general ledger.	general ledger.	
Reinsurance is not properly taken into account in accumulating claims data.	RV	AC CO	RD RRC	The insurer has established procedures to prepare the claims data for actuarial review in accordance with the insurer's reinsurance treaties.	Review the insurer's reconciliation reports of actuarial data to the insurer's claims system, reinsurance reports, and accounting records. Test the operating effectiveness of the insurer's established procedures to include claims data from assumed reinsurance treaties within the data for actuarial review.	Test reconciling items relating to reinsurance claims data for appropriateness. Verify assumed reinsurance claims data accumulated for actuarial review by comparing to the data provided by the ceding insurer for completeness.
Initial ~~case~~ claim reserves are not established or reviewed in accordance with insurer standards.	RV CR	AC VA CO	RA	The insurer has a ~~case~~ claim reserving philosophy and qualified actuaries are involved in establishing and reviewing the reserving policy. Initial reserves are made in accordance with the insurer's reserving philosophy and within a specified time frame. Claim adjusters/supervisors are required to review significant initial case reserves on a timely basis and make adjustments as necessary.	Obtain documentation supporting the insurer's reserving philosophy. Review reserving philosophy for actuary review and policy adequacy. For a sample of loss reserves, determine whether loss reserve reviews were performed and documented in accordance with insurer policy. Obtain periodic new claims reports and verify the insurer reviews significant initial case reserves and makes adjustments, if necessary, in a timely manner.	For a sample of reserves verify that the calculation is in accordance with the reserving philosophy and that reserves are calculated on a timely basis.* For a sample of reserves meeting the criteria to go to a claims committee, determine whether the reserves were referred to this committee.* Confirm a sample of unpaid claims with major providers.

Identified Risk	Branded Risk	Exam Asrt.	Critical Risks	Possible Controls	Possible Test of Controls	Possible Detail Tests
				Committees are formed to evaluate and strategize claims involving serious injuries, complex claims law, and large or unusual loss reserve determinations or settlements.	Obtain minutes and other meeting materials from the meetings of the committee to determine whether the committee provided appropriate oversight.	
~~Case~~ Claim reserves are not updated accurately.	RV CR	CO VA	RA	The insurer has a policy requiring open claims to be reviewed regularly. When new information is received, case reserves are reviewed and adjusted, if necessary. The claims management system generates analyses of reserve increases and decreases, an outstanding reserve list, an outstanding reserve list by claim adjuster, and a reserve release report. These reports are reviewed/ monitored by the claims manager for reasonableness.	From a sample of ~~case~~ claim reserves, determine whether the reserves are updated regularly and are appropriately updated when new information is received. Obtain copies of the reserve reports, noting management approval.	Select a sample of paid claims and compare the final overall claims settlement with the case reserve to determine whether the reserves are adequate and/or updated accurately. Verify that the information contained in the reports is accurate and determine whether the appropriate analyses are being used to evaluate the reserves.
The assumptions and methodologies used by the insurer for the health, long-term care and long-term disability business are not accurate and appropriate.	RV	VA AC PD	RA	The insurer uses consistent assumptions and methodologies that have been based on historical results (to the extent appropriate), adequately documented, approved by senior management and in accordance with statutory accounting principles, Actuarial Standards of Practice, and applicable state statutes and/or regulations.	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	Review assumptions and methodologies for reasonableness, appropriateness and accuracy, with assistance from the insurance department actuary or an independent actuary. Verify that reserving assumptions are in accordance with the relevant SSAPs related to health reserving, as well as any applicable state statutes,

Identified Risk	Branded Risk	Exam Asrt.	Critical Risks	Possible Controls	Possible Test of Controls	Possible Detail Tests
				Senior management uses either internal or independent actuaries to conduct reserve analyses of all major lines of business on an annual basis. Actuarial analysis is subject to a peer review process. Management receives regular reports on loss ratios by line or class of business, as well as other key ratios, and reviews unusual fluctuations on a timely basis to review reserves for adequacy. The insurer utilizes a fully staffed, well-qualified actuarial department that is under the direction of a fellow of the Society of Actuaries (FSA) or member of the American Academy of Actuaries (MAAA) and is experienced in the lines of business written by the insurer. The reserving actuarial unit's responsibilities are segregated from the pricing actuarial unit, but there is regular communication between the two units.	actuaries and that reports include reserve analyses of all major lines of business. If performed in-house, review and test the actuarial peer review process and related sign-offs. Verify management review of reserve reporting and test the operating effectiveness of procedures in place. Review the credentials, background and responsibilities of the insurer's actuarial department (internal or external) for appropriateness. Request and review the insurer's organizational chart and job descriptions to determine whether the functions are separate and distinct. Interview the appointed actuary during the planning	regulations, actuarial guidelines, pronouncements and/or bulletins. Review prior history of claims development, as well as subsequent claims development data to analyze the reasonableness of assumptions and methodologies. Determine whether the appropriate disclosures have been made in the Notes to the Financial Statements for the changes in reserve methodologies. Review actuarial reports and compare reports to prior periods. Investigate significant variations. Utilize the insurance department actuary or an independent actuary to perform an independent calculation/estimate of the reserves. Review correspondence related to peer review for appropriate depth of review. Compare the opining actuary's assumptions and estimates with those in other available actuarial analyses.

Identified Risk	Branded Risk	Exam Asrt.	Critical Risks	Possible Controls	Possible Test of Controls	Possible Detail Tests
				The insurer's organizational structure limits the influence that management can have on the appointed actuary. The insurer has appropriately established procedures to include policy lapse rates when calculating the reserving estimates.	phase of the examination to determine whether the insurer's organizational structure is appropriate in this area. Review insurer processes in place to calculate the reserve calculations to ensure consideration is given to policy lapse rates.	Determine whether the Actuarial Opinion was changed by the appointed actuary after meeting with insurer management.
The claims unpaid, claims reserve, policy reserve and premium deficiency reserve computations are not performed correctly or the selected estimates are unreasonable.	OP RV	AC VA	RA	The insurer has an established process (although assumptions and methodologies may change) to estimate the claims unpaid, claim reserves, policy reserves and premium deficiency reserves on an annual basis. The insurer maintains a fully staffed, well-qualified actuarial department that is under the direction of a fellow of the Society of Actuaries (FSA) or member of the American Academy of Actuaries (MAAA) and is experienced in the lines of business written by the insurer. Senior management uses either internal or independent actuaries to conduct reserve analyses of all major lines on an annual	Review the process in place (which may include performance of a walkthrough) to estimate the claims unpaid, claim reserves, policy reserves and premium deficiency reserves. Review the credentials, background and responsibilities of the insurer's actuarial department staff for appropriateness. Obtain actuarial reports to verify insurer is using either independent or in-house actuaries to perform the reserve calculations on all	Utilize the insurance department actuary or an independent actuary to perform an independent estimate of the claims unpaid, claims reserve, policy reserve and premium deficiency reserves. Perform analytical procedures to review the reasonableness of reserve estimates.

Identified Risk	Branded Risk	Exam Asrt.	Critical Risks	Possible Controls	Possible Test of Controls	Possible Detail Tests
				basis. The actuarial calculations are subject to a peer review process**.** The insurer's board of directors (or committee thereof) receives an annual presentation on the actuarial analysis process. Management receives regular reports on claims ratios (including claims unpaid, claims reserve, policy reserve and premium deficiency reserve) by line or class of business for accident year and calendar year, as well as other key ratios, and reviews unusual fluctuations on a timely basis to review reserves for adequacy.	major lines of business annually and verify senior management review. If performed in-house, review and test the actuarial peer review process and related sign-offs**.** Review the board of directors (or committee thereof) minutes to verify that a presentation was given on the actuarial analysis process. Verify management review of reserve reporting and test the operating effectiveness of procedures in place.	
The claims adjustment expense (CAE) computations are not performed correctly.	OP RV	AC VA CO	RA	The insurer has established processes to estimate both the cost containment and other claim adjustment reserves on an annual basis. The insurer maintains a fully staffed, well-qualified actuarial department that is under the direction of a	Review the processes (which could include a walkthrough) in place to calculate both the cost containment and other claim adjustment reserves. Review the credentials, background and responsibilities of the insurer's actuarial	Utilize the insurance department actuary or an independent actuary to perform an independent calculation/estimate of the CAE. Perform analytical procedures to review the reasonableness of CAE calculations.

Identified Risk	Branded Risk	Exam Asrt.	Critical Risks	Possible Controls	Possible Test of Controls	Possible Detail Tests
				fellow of the Society of Actuaries (FSA) or member of the American Academy of Actuaries (MAAA) and is experienced in the lines of business written by the insurer.	department staff for appropriateness. Obtain actuarial reports to verify the insurer is using either independent or in-house actuaries to perform separate cost containment and other claim adjustment reserve analyses on an annual basis.	
				Senior management uses either internal or independent actuaries to conduct separate cost containment and other claim adjustment reserve analysis of all major lines on an annual basis.	Verify senior management review of reports from actuaries.	
				The actuarial analyses are subject to a peer review process.	If the analyses are performed in-house, review and test the actuarial peer review process and related sign-offs.	
				The insurer's board of directors (or committee thereof) receives an annual presentation on the actuarial analysis process.	Review the board of directors' (or committee thereof) meeting minutes to verify whether a presentation was given on the actuarial analysis process.	
				Management receives regular reports on loss ratios by line or class of business, as well as other key ratios, and reviews unusual	Verify management review of reserve reporting and test the operating effectiveness of procedures in place.	

Identified Risk	Branded Risk	Exam Asrt.	Critical Risks	Possible Controls	Possible Test of Controls	Possible Detail Tests
				fluctuations on a timely basis to review reserves for adequacy.		
Changes in the legal environment or changes in the insurer's underwriting, reserving or claims handling processes are not appropriately considered within the insurer's reserving assumptions and methodologies.	OP RV ST	VA PD AC	RA	The insurer has procedures in place for its legal department to monitor and communicate changes in the legal environment (e.g., changes in case law, award amounts, trends in the number of claims being litigated) are being taken into consideration by the reserving unit in a timely manner. The insurer has procedures in place for the underwriting, case reserving and claims handling units to communicate changes in their processes to the reserving unit in a timely manner.	Review the insurer's process to monitor changes in the legal environment that may affect the reserving process. Review evidence of communication between the reserving unit and other relevant insurer units.	Through a review of the actuarial reports, determine whether changes in the legal environment and/or changes in the insurer's internal processes have been properly incorporated in the insurer's reserving assumptions and methodologies.
The computations of reinsurance credits within the reserves are not performed correctly. (See also Examination Repository – Reinsurance Ceding Insurer)	CR RV	AC VA CO	RA RRC	The reserving actuary calculates the reserve on a gross basis and determines the net basis by estimating the reinsurance credits and applying them to the gross reserve. The insurer applies reinsurance credits to reserves by reviewing reinsurance treaties in place at the insurer, as well as historical results.	Test the operating effectiveness of the insurer's process for reviewing the reserve analysis to determine whether reserves have been estimated on a gross basis, including management approval and sign-off. Test the operating effectiveness of the insurer's process to estimate reinsurance credits for reserves, including management approval and	Compare the annual financial statement net and gross incurred and paid loss presentation for consistency with reinsurance treaties in place at the insurer. Consider the reasonableness of reinsurance credits taken, based on a review of the insurer's reinsurance program and treaties in place.

Identified Risk	Branded Risk	Exam Asrt.	Critical Risks	Possible Controls	Possible Test of Controls	Possible Detail Tests
					sign-off.	
The insurer is not properly recording case reserves (assumed or ceded) for contracts subject to reinsurance.	RV CR LG	CO VA AC	RA RRC	The insurer has policies in place to verify that case reserves subject to reinsurance are valid and accurate (within contract time frame, covered under the contract, etc.).	Review insurer policies to determine appropriateness, noting management approval. Review documentation of insurer's review of claim validity.	Utilize the NAIC Examination Jumpstart report to determine whether case reserves recorded by the insurer agree with the case reserves of the assuming (ceding) insurer.
Management books reserves that are materially different than the actuary's best estimate.	OP ST LG	VA PD	RA	The insurer has a process in place to ensure that reserves are recorded based on the actuary's best estimate, or documents an appropriate reason for any deviations. The board of directors (or committee thereof) reviews management's best estimate of booked reserves and challenges such estimates based on reports received, including the actuarial report from the appointed actuary. The insurer's organizational structure limits the influence that management can have on the appointed actuary.	Review management guidelines regarding the recording of actuarially determined reserves. Verify that deviations from the actuary's best estimate are properly documented, if applicable. Review the board of directors (or committee thereof) meeting minutes ~~to~~ for evidence of a presentation and review of information supporting management's best estimate of the booked reserves (i.e., the actuarial report). Interview the appointed actuary during the planning phase of the examination to determine whether the insurer's organizational structure is appropriate in this area.	Review the actuarial report, as well as the annual financial statements and other appropriate documentation, to determine whether the insurer has booked the actuary's best estimate. Review the documentation supporting a deviation from the actuary's best estimate for reasonableness, if applicable.
The insurer does not maintain an adequate premium deficiency reserve.	RV ~~RQ~~LQ OP	VA CO CM	RA	The insurer has a process in place to review for premium deficiencies on an annual basis in accordance with SSAP No. 54.	Review the process in place and verify key controls surrounding the calculation of premium deficiency reserves.	Perform an analytical review of loss ratios. If necessary, utilize the insurance department actuary or an independent

Identified Risk	Branded Risk	Exam Asrt.	Critical Risks	Possible Controls	Possible Test of Controls	Possible Detail Tests
Note: It may also be appropriate to consider reserves for insufficient administrative fees for self-insured contracts.				Independent actuaries review and sign off on premium deficiency reserve calculations.	Obtain the actuarial opinion and verify approval of premium deficiency reserve calculations.	actuary to perform a detailed review or an independent calculation/estimate of the premium deficiency reserves.

EXAMINATION REPOSITORY – RESERVES/CLAIMS HANDLING (P&C)

Commented [HB1]: Unless otherwise noted, revisions herein have been developed by the volunteer drafting group of the FEHTG, with input from AOWG, LATF and HATF.

Annual Statement Blank Line Items

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

Losses
Loss Adjustment Expenses
Ceded Reinsurance Case Loss and Loss Adjustment Expense Reserves
Supplemental Reserve (*Title Companies*)

Relevant Statements of Statutory Accounting Principles (SSAPs)

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

No. 5R Liabilities, Contingencies and Impairments of Assets – Revised
No. 54R Individual and Group Accident and Health Contracts
No. 55 Unpaid Claims, Losses and Loss Adjustment Expenses
No. 57 Title Insurance
No. 62R Property and Casualty Reinsurance – Revised
No. 63 Underwriting Pools
No. 65 Property and Casualty Contracts
No. 70 Allocation of Expenses

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
Other Than Financial Reporting Risks						
The board of directors (or committee thereof) is not involved in establishing and/or reviewing the insurer's overall reserving ~~practices~~policy.	OP RV ST	Other	RA	The insurer's board of directors (or committee thereof) has adopted and/or reviewed the insurer's overall reserving ~~practices~~policy. The board of directors (or committee thereof) regularly discusses reserving issues/levels and receives reports from the ~~appointed~~ Appointed ~~actuary~~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~~ policy as needed.	Verify that the insurer has established an overall reserving ~~practices~~ policy that ~~have~~ has been adopted and/or reviewed by the board of directors (or committee thereof). Review board of directors (or committee thereof) minutes to ensure discussion of reserving. Verify that the minutes indicate that the Appointed Actuary reported to the board (or committee thereof) on the items within the scope of the actuarial opinion an identifies the manner of presentation. Obtain information on revisions made by the insurer to its reserving ~~practices~~ policy and verify the revisions were appropriately reviewed and/or approved by the board of directors (or committee thereof). Verify that the insurer's reserving process was reviewed and/or approved by the board of directors (or committee thereof).	Obtain information on the insurer's overall reserving ~~practices~~ policy and forward it to the insurance department actuary or an independent actuary for review. Discuss with members of the board of directors (or committee thereof) their level of involvement in the monitoring of reserving ~~practices~~ policy.
Financial Reporting Risks						
New claims are not entered into the claims	RP LG	AC CT	RD	Segregation of duties exists between the claim	Observe that segregation of duties exists between the	Select a sample of items from the exception reports

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
management system.		CO		notification and the input of claims data into the claims system. Control reports exist to ensure all claims reported to the insurer electronically or manually have been entered into the claims system. Exceptions are identified and resolved timely. The insurer reviews the Type II SOC 1 report and ensures compliance with user control considerations for any outsourcing companies that enter claims on behalf of the insurer.	claim notification and the input of claims data into the claims system. Obtain the exception report and ensure management review and exception resolution. Test the operating effectiveness of the automated claims posting process through reperformance and observation, which could include IT testing of batch totals to ensure completeness of transactions processed. Obtain documentation of the management's review of the Type II SOC 1 report.	and verify that the claim was appropriately accounted for.* Select a sample of claim and expense payments made subsequent to year-end to verify that claims were recorded in the proper period. Review the Type II SOC 1 report, including any bridge letters, to ensure there are no significant control deficiencies or internal control weaknesses related to processing new claims into the claims system.
Claims data is incomplete or incorrectly entered into the claims management system.	OP LG	AC CT CO EX	RD	Claims data is subject to independent verification or quality assurance (QA) reviews. The claims system has automated controls that will not allow a claim to be entered without a valid in-	Obtain documentation of independent claim verification or QA review. Ensure reviews performed address the completeness and accuracy of underlying claims information entered into the claims system. Test the operating effectiveness of automated controls (i.e., edit checks) through reperformance and	Perform data validation tests to verify the accuracy of claim information maintained in the claims system — such as coverage terms, demographic data, loss occurrence and/or loss report date, date of service, insured name, claim number and coverage period — by vouching the information to the claimant's insurance contract, claims form and

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				force policy. The claims system has automated controls that will not permit continued processing until all pertinent claim data has been entered. Entering a valid active policy number will automatically populate select policy data. System edits will identify data that does not meet the predetermined criteria resulting in inclusion on a system generated exception report. Segregation of duties exists between individuals responsible for new claim set-up and those responsible for setting up new policies.	observation. Obtain the error report and ensure proper exception resolution. Test the operating effectiveness of authority restrictions through reperformance and observation. Obtain claims set-up and new policy set-up authorization listings and cross-reference the listings to ensure that there are no employees with conflicting authority.	any other underlying support. Scan the database(s) for internal inconsistencies, such as missing claim amounts, unusually small amounts and claims misclassified by type. In situations where adequate segregation of duties is not apparent, obtain data to determine whether any claims were set up by the same user who created the corresponding policy in the master file. If any instances are identified, investigate the claim to ensure the claim exists and is supported by underlying data.
The third-party administrators (TPAs) or managing general agents (MGAs) are not processing claims in accordance with the insurer's claims procedures as outlined in the TPA agreement.	LG OP RP	AC CM	RD	The insurer performs regular audits of its TPAs/MGAs to determine whether the insurer's claims-handling standards and additional contract provisions are being consistently followed by the TPA. Management obtains a Type II SOC 1 report for all TPAs and reviews the report to verify the TPA has adequate controls and that the insurer	Review audit reports and other documentation to determine whether the insurer provides sufficient oversight of its TPAs/MGAs. Verify that the insurer has obtained and reviewed each TPA's Type II SOC 1 report, if available. Determine whether the	Determine, by a review of selected claims, whether the insurer is settling its claims accurately and in accordance with the contract, based on information contained in the claim file. Review the Type II SOC 1 report to determine whether the controls outlined in the report are adequate to ensure that claims are being processed in accordance

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				is adhering to user control considerations. Management performs necessary reviews to comply with applicable state MGA regulations.	insurer is adhering to user control considerations. Obtain evidence of management's review of compliance with applicable state MGA regulations.	with the TPA agreement. Test for compliance with applicable state MGA regulations.
Claims are not being processed accurately and in accordance with the insurer's guidelines.	OP ST LG	AC CM CO	RD	The insurer has administrative policies and maintains a claims procedures manual that outlines the following requirements: • Proper application of deductibles. • Reserving and payment authority and approval levels. • File documentation and tracking. • Procedures for handling suspicious or fraudulent claims. • Compliance with the domiciliary state's fair claims practices laws and regulations. Paid losses are not to exceed policy limits, cover ineligible loss causes/types and/or apply to a policy period for which the insurer is not contractually responsible. Any consideration to pay a	Review the insurer's claims manual to determine appropriateness including management approval. Test the operating effectiveness of system edit checks to ensure procedures are implemented through reperformance and observation. Review assessments of the claims-handling process	Perform tests to determine whether claims were accurately processed in accordance with the claims procedures manual, approved authority limits and administrative policies, through review of the claimant's insurance contract, claims form and any other underlying support.* Review policyholder complaints and investigate significant issues. Review a sample of denied claims to ensure compliance with contract and timeliness provisions.

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				loss that meets one or more of the aforementioned categories must be processed in accordance with the insurer's procedures. As part of the claims processing procedures, the insurer obtains adequate documentation before a claim is settled. Claims approval is subject to approved authority limits. A QA review is periodically performed for each claims processor to ensure compliance with the claims-handling policies.	performed by internal/external auditors, reinsurers and/or others for significant issues. Test the operating effectiveness of controls to ensure adequate documentation is obtained before payment is made. Test the controls in place to ensure that claims are approved in accordance with documented authority limits. Review documentation of QA reviews to determine whether the QA function is being executed as outlined in the insurer's policies. On a sample basis, reperform the QA testing to ensure that the testing was completed accurately.	
Claims under claims-made liability policies are improperly accepted (or rejected) by the claims adjusters.	RP RV OP ST	AC CM	RD	The insurer has a policy in place whereby coverage is automatically triggered under claims-made liability policies when a claim is first made during the policy period (as long as it did not occur prior to the retroactive policy date specified). A QA review is periodically	Perform a walkthrough to verify that the adjuster properly applies tail coverage to the claim and reallocates the claim to the correct policy year. Review documentation of	Perform data validation testing to ensure that claims under claims-made liability policies are being properly administered.

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				performed for each claims processor to ensure compliance with claims-handling policies	QA reviews to determine whether the QA function is being executed as outlined in the insurer's policies. On a sample basis, reperform the QA review to ensure the testing was accurately completed.	
The claims data utilized by the actuary to estimate reserves does not correspond to the data in the insurer's claims system and to the data in the insurer's accounting records.	OP RV	AC CO	RD	The insurer has established procedures to reconcile actuarial data to the insurer's claims system, the data in the insurer's accounting records and appropriate annual financial statement schedules and/or exhibits. Such reconciliations are reviewed by supervisory personnel. Inventories of reported and unpaid claims are maintained and periodically reconciled to the general ledger. The Appointed Actuary reconciles the claims data used in the analysis to Schedule P. The insurer has established procedures to prepare complete and accurate data for actuarial review.	Review the insurer's reconciliation reports of actuarial data to the insurer's claims system and the insurer's accounting records. Ensure evidence of supervisory review. Review the insurer's reconciliation of reported and unpaid claims to the general ledger. Review the Appointed Actuary's reconciliation of the claims data used in the analysis to Schedule P. Test the operating effectiveness of the insurer's established procedures to prepare the claims data for actuarial review.	Test reconciling items within the reconciliations for appropriateness. Reconcile the insurer's actuarial report for losses and loss adjustment expenses to supporting insurer reports, general ledger, and annual financial statement schedules and exhibits as of the valuation date. Independently reconcile the actuarial data to Schedule P.

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
Reinsurance is not properly taken into account in accumulating claims data. (See also Examination Repository – Reinsurance Ceding Insurer)	RV	AC CO	RD	The insurer has established procedures to prepare the claims data for actuarial review in accordance with the insurer's reinsurance treaties.	Review the insurer's reconciliation reports of actuarial data to the insurer's claims system, reinsurance reports, and accounting records. Test the operating effectiveness of the insurer's established procedures to include loss data from assumed reinsurance treaties within the claims data for actuarial review.	Test reconciling items relating to reinsurance loss data for appropriateness. Verify assumed reinsurance loss data accumulated for actuarial review by comparing to the data provided by the ceding insurer for completeness.
Initial case reserves are not established or reviewed in accordance with the insurer's standards.	RV CR	AC VA CO	RA	The insurer has a case reserving philosophy, and qualified actuaries are involved in establishing and reviewing the reserving policy. Initial reserves are made in accordance with the insurer's reserving philosophy and within a specified time frame. Claims adjusters/ supervisors are required to review significant initial case reserves on a timely basis and make adjustments as necessary. The insurer verifies that the TPAs that process claims follow the insurer's	Obtain documentation supporting the insurer's reserving philosophy. Review the reserving philosophy for actuarial review and policy adequacy. For a sample of loss reserves, determine whether loss reserve reviews were performed and documented in accordance with the insurer's policy. Obtain periodic new claims reports and verify the insurer reviews significant initial case reserves and makes adjustments, if necessary, in a timely manner.	For a sample of reserves, verify that the calculation is in accordance with the reserving philosophy and that reserves are calculated on a timely basis. For a sample of reserves meeting the criteria to go to a claims committee, determine whether the reserves were referred to this committee.*

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				guidelines for setting case reserves on reported claims. Committees are formed to evaluate and strategize claims involving serious injuries, complex claims law, and large or unusual loss reserve determinations or settlements.	 Obtain minutes and other meeting materials from the meetings of the committee to determine whether the committee provided appropriate oversight.	
Case reserves are not updated accurately.	RV CR	CO VA	RA	The insurer has a policy requiring open claims to be reviewed regularly. When new information is received, case reserves are reviewed and adjusted, if necessary. The claims management system generates analyses or reports that identify reserve increases and decreases, an outstanding reserve list, an outstanding reserve list by claims adjuster and a reserve release report. These reports are reviewed/ monitored by the claims manager for reasonableness.	From a sample of case reserves, determine whether the reserves are updated regularly and are appropriately updated when new information is received. Obtain copies of the reserve reports, noting management approval.	Select a sample of paid claims and compare the final overall claims settlement with the case reserve to determine whether the reserves are adequate and/or updated accurately.* Verify that the information contained in management reserve reports is accurate and complete and determine whether the appropriate analysis is being used to evaluate the reserves.
The insurer is not properly recording case reserves (assumed or ceded) for contracts subject to reinsurance.	RV CR LG	CO VA AC	RA	The insurer has policies in place to verify that case reserves subject to reinsurance are valid and accurate (within contract time frame, covered under the contract, etc.).	Review the insurer's policies to determine appropriateness, noting management approval. Review documentation of the insurer's review of claim validity.	Utilize NAIC Examination Jumpstart reports to determine whether case reserves recorded by the insurer agree with the case reserves of the assuming (ceding) insurer.
~~The assumptions and methodologies used~~ Actuarial analyses	RV	VA AC PD	RA	The insurer's actuarial analyses use~~s consistent assumptions and~~	Gain an understanding of the ~~insurer's assumptions and methodologies~~ methods	Review the actuarial analyses' methodologies for appropriateness and

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
relied upon by the insurer's management in determining carried reserves are not based on~~accurate and~~ appropriate methods and/or reasonable assumptions.				~~methodologies~~ appropriate methods and reasonable assumptions that have been based on historical results (to the extent appropriate), adequately documented, approved by senior management and in accordance with statutory accounting principles and applicable state statutes and/or regulations. ~~Senior management uses internal or independent actuaries to conduct reserve analyses of all major lines of business on an annual basis.~~ Actuarial analys~~i~~es relied upon by management in determining carried reserves ~~is~~ are subject to a peer review process. Management receives regular reports on loss/LAE reserve levels, loss/LAE ratios (including incurred but not reported (IBNR)) by line or class of business grouped by accident year and calendar year, as well as other key ratios, and reviews unusual fluctuations on a timely basis to review reserves for adequacy.	and assumptions used in the analyses ~~and~~ compared 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.~~ If performed in-house, review and test the actuarial peer review process and related sign-offs. Verify management review of loss/LAE reserve reporting and test the operating effectiveness of procedures in place. Review the credentials, background and responsibilities of the insurer's actuarial function	assumptions ~~and methodologies~~ for reasonableness, ~~appropriateness and accuracy~~ with assistance from the insurance department actuary or an independent actuary. Verify that reserving methodologies and assumptions are in accordance with the relevant SSAPs related to P&C reserving, as well as applicable statutes, regulations, pronouncements and/or bulletins. Review prior history of loss development, as well as subsequent loss development data to analyze the appropriateness of methodologies and reasonableness of assumptions ~~and methodologies~~. Determine whether the appropriate disclosures have been made in the Notes to the Financial Statements for the changes in the insurer's reserve methodologies. Review actuarial reports and compare reports to prior periods. Investigate

Commented [HB2]: Revision proposed by AOWG/CASTF

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				The insurer utilizes a fully staffed, well-qualified actuarial function that is under the direction of an actuary that has an Accepted Actuarial Designation, as defined in the NAIC Statement of Actuarial Opinion Instructions, ~~fellow (or associate) of the Casualty Actuary Society (FCAS)~~ and is experienced in the lines of business written by the insurer. The reserving actuarial unit's responsibilities are segregated from the pricing actuarial unit, but there is regular communication between the two units. The insurer's ~~organizational structure limits the influence that~~ management ~~can have on~~ does not inappropriately influence the methods, assumptions, or conclusions of the ~~appointed actuary~~Appointed Actuary.	(internal or external) for appropriateness. Request and review the insurer's organizational chart and job descriptions to determine whether the functions are separate and distinct. Interview the ~~appointed actuary~~Appointed Actuary during the planning phase of the examination to ~~determine whether the insurer's organizational structure is appropriate in this area~~ascertain the degree of influence the insurer's management has on the Appointed Actuary's work.	significant variations. Utilize the insurance department actuary or an independent actuary to perform an independent calculation/estimate of the loss/LAE reserves for significant reserve segments with volatility if necessary. Review the external auditor's reserve level calculations when available and Appointed Actuary's report; independent tests should only be conducted if other tests are not conclusive. Review correspondence related to peer review for appropriate depth of review. Compare the ~~opining actuary's~~ Appointed Actuary's assumptions and estimates with those in other available actuarial analyses. Determine whether the Actuarial Opinion was changed by the ~~appointed actuary~~Appointed Actuary after meeting with insurer management.
Catastrophe-type (CAT) claims or large or significant exposure type claims data are not separately	OP RV	AC VA	RD RA	The insurer has established procedures to prepare the claims data for actuarial review by extracting CAT claims or large or	Test the operating effectiveness of the insurer's established procedures to prepare the claims data for actuarial	Obtain a detailed download of all claim transactions during the examination period. Utilize audit software to verify that

Commented [HB3]: Revision proposed by AOWG/CASTF

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
identified and evaluated from other claims.				significant exposure type claims, for a separate reserve analysis.	review. Review the insurer's actuarial reserve analysis for incorporation of a separate review of CAT claims or large or significant exposure type claims.	claims data appropriately distinguishes CAT claims or large or significant exposure type claims and that these claims have been extracted from the general claims data and presented separately to the actuary.
Changes in the legal environment or changes in the insurer's underwriting, case reserving or claims-handling processes are not appropriately considered within the insurer's reserving assumptions and methodologies.	OP RV ST	VA PD AC	RA	The insurer has procedures in place ~~for its legal department~~ to monitor and communicate changes in the legal environment (e.g., changes in case law, award amounts, trends in the number of claims being litigated) are being taken into consideration by ~~the reserving unit~~ management in a timely manner. The insurer has procedures in place for the underwriting, case reserving and claims-handling units to communicate changes in their processes to the reserving unit in a timely manner.	Review the insurer's process to monitor changes in the legal environment that may affect the reserving process and to reflect changes appropriately in management's determination of carried reserves. Review evidence of communication between the reserving unit and other relevant insurer units.	Through a review of ~~the actuarial reports~~documentation supporting management's carried reserves, determine whether changes in the legal environment or changes in the insurer's internal processes have been properly incorporated ~~in the insurer's reserving assumptions and methodologies~~.
The loss and loss adjustment expense (LAE) reserve computations are not performed correctly or the selected estimates are unreasonable.	OP RV	AC VA	RA	The insurer has an established process (although assumptions and methodologies may change) to estimate the loss reserves on an annual basis. The insurer has established processes to estimate the defense and cost	Review the process in place (which may include performance of a walkthrough) to estimate the loss reserves. Review the processes (which may include a walkthrough) in place to	Utilize the insurance department actuary or an independent actuary to perform an independent estimate of the loss reserves. Utilize the insurance department actuary or an independent actuary to

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				containment (DCC) and the adjusting and other (AO) loss adjustment expense reserves on an annual basis. The insurer maintains a fully staffed, well-qualified actuarial department that is under the direction of a fellow (or associate) of the Casualty Actuary Society (FCAS) and is experienced in the lines of business written by the insurer. Senior management uses either internal or independent actuaries to conduct reserve analyses of all major lines on an annual basis. The actuarial calculations are subject to a peer review process**.** The insurer's board of directors (or committee thereof) receives an annual presentation on the actuarial analysis process. Management receives regular reports on loss ratios (including IBNR) by line or	estimate both the DCC and AO loss adjustment expense reserves. Review the credentials, background and responsibilities of the insurer's actuarial department staff for appropriateness. Obtain actuarial reports to verify insurer is using either independent or in-house actuaries to perform the reserve calculations on all major lines of business annually and verify senior management review of reports from actuaries. If performed in-house, review and test the actuarial peer review process and related sign-offs**.** Review meeting minutes of the board of directors (or committee thereof) to verify that a presentation was given on the actuarial analysis process. Verify management review of loss reserve reporting and test the operating	prepare an independent estimate of LAE. Perform analytical procedures to review the reasonableness of loss reserve estimates.

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				class of business for accident year and calendar year, as well as other key ratios, and reviews unusual fluctuations on a timely basis to review reserves for adequacy.	effectiveness of procedures in place.	
~~The computation of reinsurance credits within loss reserves are not performed correctly.~~ ~~(See also Examination Repository – Reinsurance Ceding Insurer.)~~	~~CR~~ ~~RV~~	~~AC~~ ~~VA~~ ~~CO~~	~~RA~~	~~The reserving actuary calculates the reserve on a gross basis and determines the net basis by estimating the reinsurance credits and applying them to the gross reserve.~~ ~~The insurer applies reinsurance credits to loss reserves by reviewing reinsurance treaties in place at the insurer, as well as historical results.~~	~~Test the operating effectiveness of the insurer's process for reviewing the reserve analysis to determine whether loss reserves have been estimated on a gross basis, including management approval and sign-off.~~ ~~Test the operating effectiveness of the insurer's process to estimate reinsurance credits for loss reserves, including management approval and sign-off.~~	~~Compare the annual financial statement's net and gross incurred and paid loss presentation for consistency with reinsurance treaties in place at the insurer.~~ ~~Consider the reasonableness of reinsurance credits taken, based on a review of the insurer's reinsurance program and treaties in place.~~ ~~Utilize the insurance department actuary or an independent actuary to review the reasonableness of the ceded reinsurance estimates contained in the opining actuary's report.~~
~~Management books reserves that are materially different than the actuary's best estimate.~~ Management does not have reasonable support for its carried reserves.	OP ST LG	VA PD	RA	The insurer has a process in place ~~to ensure that reserves are recorded based on the actuary's best estimate, or documents an appropriate reason for any deviations~~ for determining carried reserves, and management is able to explain its selection.	Review management's guidelines regarding the ~~recording of actuarially determined loss~~determination of carried reserves. Verify that any material changes from the prior year's reserves and any material ~~deviations~~ differences between ~~from~~ carried reserves and the	~~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.~~ Review the documentation supporting management's

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				The board of directors (or committee thereof) reviews management's best estimate of ~~booked~~ reserves and challenges such estimates based upon reports received, including the actuarial report from the ~~appointed actuary~~Appointed Actuary. ~~The insurer's organizational structure limits the influence that management can have on the appointed actuary.~~	~~actuary~~Appointed Actuary's ~~best~~ point estimate are properly documented~~, if applicable~~. Review meeting minutes of the board of directors (or committee thereof) minutes for evidence of a presentation and review of information supporting management's best estimate of the booked reserves (~~i.e.~~ e.g., the actuarial report). ~~Interview the appointed actuary during the planning phase of the examination to determine whether the insurer's organizational structure is appropriate in this area.~~	carried reserves, including management's analysis of the reasonableness of the reserve estimates. ~~a deviation from the actuary's best estimate for reasonableness, if applicable.~~
The insurer does not maintain an adequate premium deficiency reserve.	RV RQ OP	VA CO CM	RA	The insurer has a process in place to review for premium deficiencies on an annual basis in accordance with SSAP No. 5~~4~~3. ~~Independent actuaries~~ Qualified personnel perform, review, and sign off on premium deficiency reserve calculations.	Review the process in place and verify key controls surrounding the calculation of premium deficiency reserves. Obtain the ~~actuarial opinion and verify approval of~~premium deficiency reserve calculations, and verify approval and sign-off.	Perform an analytical review of loss ratios. If necessary, utilize the insurance department actuary or an independent actuary to perform a detailed review or an independent calculation/estimate of the premium deficiency reserves.

EXAMINATION REPOSITORY – RESERVES/CLAIMS HANDLING (LIFE)

Commented [HB1]: Unless otherwise noted, revisions herein have been developed by the volunteer drafting group of the FEHTG, with input from AOWG, LATF and HATF.

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. 51R	Life Contracts
No. 54R	Individual and Group Accident and Health Contracts
No. 55	Unpaid Claims, Losses and Loss Adjustment Expenses
No. 61R	Life, Deposit-Type and Accident and Health Reinsurance – Revised
No. 63	Underwriting Pools
~~No. 70~~	~~Allocation of Expenses~~

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
Other Than Financial Reporting Risk						
The board of directors (or committee thereof) is not involved in establishing and/or reviewing the insurer's overall reserving practices.	ST RV	Other	RA	The insurer's board of directors (or committee thereof) has adopted and/or reviewed the insurer's overall reserving practices. The board of directors (or committee thereof) regularly discusses reserving issues and receives reports from the appointed actuary. The 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.	Verify that the insurer has established overall reserving practices that have been adopted and/or reviewed by the board of directors (or committee thereof). Review board of directors (or committee thereof) minutes to ensure discussion of reserving. Review meeting materials to determine if materials would properly facilitate BOD oversight. ~~Review board of directors (or committee thereof) minutes to ensure regular discussion of reserving issues including reports (at least annually) from the appointed actuary.~~ Obtain information on revisions made by the insurer to its reserving practices and verify the revisions were appropriately reviewed and/or approved by the board of directors (or committee thereof).	Obtain information on the insurer's overall reserving practices and forward it to the insurance department actuary or an independent actuary for review. Discuss with members of the board of directors (or committee thereof) their level of involvement in monitoring the implementation of reserving practices.
The insurer has not taken appropriate steps to prepare for the implementation of Principle-Based Reserving (PBR).	RV ST	Other	RA RD	The insurer has a PBR implementation plan that includes consideration of staffing needs and appropriate expertise in current and/or future budgets and strategic plans.	Verify that budgets and/or strategic plans contain consideration of PBR implementation needs including qualified staff. Determine if the company	Review the insurer's PBR implementation plan for reasonableness. Review actuarial department staff qualifications to determine

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
Note: Under the requirements of the Valuation Manual, companies have until 1/1/2020 to implement PBR requirements. See Section 1, VI, ~~6~~ for further information on the implementation of PBR.				The insurer has a process to monitor the progress and ongoing needs of PBR implementation. Process includes consideration of exempted products. Data reporting and system needs are reviewed by management on a periodic basis in preparation for PBR implementation.	has adequate suitability requirements in place for the actuarial department that requires the actuarial staff to be qualified to implement and practice a PBR methodology. Review the insurer's procedures to determine if pending PBR implementation needs are continuously monitored by company personnel. Consider if certain products have been exempted and the appropriateness of that determination. Verify that management reviews data reporting and system needs.	if suitability requirements are met and/or determine if actuarial staff has adequate training available for implementation of PBR. Consider involving an IT specialist in a review of system capabilities necessary for PBR implementation.
Financial Reporting Risks						
In-force data is not complete or accurate nor consistent with accounting records	OP RV	CO AC	RD	The insurer has established appropriate internal controls over the input and maintenance of in-force data as outlined in the Examination Repository – Underwriting. The in-force data is tested periodically by the insurer's quality assurance (QA) function for completeness and accuracy. The insurer's system is	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	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.*

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				programmed to issue insurance contracts utilizing sequential policy numbers. In-force database is reconciled to accounting records on a periodic basis.	and/or reperformance that system parameters prohibit the issuance of non-sequential policy numbers. Ensure management review of exceptions. Test reconciliation process for supervisory review, appropriateness and operating effectiveness.	In conjunction with the testing performed in the Examination Underwriting Repository, select a sample of in-force insurance contracts to verify that the system data reflects the actual insurance contract provisions.* Review complaint logs for misapplied payments, missing policy documentation and investigate the status of the complaint. Reconcile data elements to AS reporting.
The data utilized in the company's PBR model is not representative and consistent with the company's in-force data.	OP RV	AC CO	RD	The insurer maintains a model validation process to confirm that model cells represent actual inforce 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: *Issue age *Gender *Policy counts *Face amounts *Fund values *Annualized premium	Compare in-force aggregation and statistics for products under scope of PBR to model output reports at period zero for attributes such as: *Average issue age *Gender distribution *Total policy counts *Total face amounts *Total fund values *Total annualized premium
In-force data is not appropriately restricted and protected to maintain accurate and complete	OP	AC CO EX	RA RD	The insurer maintains logical access controls, including password protection and active directories, to properly	Test the operating effectiveness of logical access controls by reviewing documentation relating to requests for	Select a sample of in-force policy data at the examination as of date for accuracy and completeness testing. *

Identified Risk	**Branded Risk**	**Exam Asrt.**	**Critical Risk**	**Possible Controls**	**Possible Test of Controls**	**Possible Detail Tests**
data.				restrict access to in-force data. 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.	access and by attempting to have unauthorized individuals access the in force data. Test the operating effectiveness of segregation controls by attempting to have individuals authorized 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.	Test a sample of changes made to in-force policies during the year by reviewing supporting documentation.*
Reinsurance is not properly taken into account in accumulating in-force data. (See also Examination Repository – Reinsurance Assuming Insurer.)	RV	AC CO	RD RRC	The insurer has established procedures to prepare the in-force data for actuarial review in accordance with the insurer's reinsurance treaties.	Review the insurer's reconciliation reports of actuarial data to the insurer's in-force system, reinsurance reports, and accounting records. Test the operating effectiveness of the insurer's established procedures to include in-force data from assumed reinsurance treaties within the data for actuarial review.	Test reconciling items relating to reinsurance in-force data for appropriateness. Verify the assumed reinsurance in-force data accumulated for actuarial review by comparing to the data provided by the ceding insurer for completeness. Utilize the NAIC Examination Jumpstart report to compare in-force amounts reported by the

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
						assuming insurer to those amounts reported by the ceding insurer.
The insurer does not properly monitor XXX/AXXX reserve development related to its ceded reinsurance transactions. Note: The Financial Analysis Handbook (V.C. Domestic and/or Non-Lead State Analysis) has several procedures that may be relevant in the evaluation of captive reinsurance transactions and the related reserves.	RV	AC VA	RA RRC	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.	Review the insurer's process to monitor experience on ceded reinsurance transactions and verify that material adverse deviations are reviewed by management.	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.
The assumptions and methodologies used by the insurer for determining the reserves for life, A&H and deposit-type contracts are not accurate or appropriate.	RV	VA AC PD	RA	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. Senior management uses	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,	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

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				internal or independent actuaries to conduct reserve analyses of all major lines of business on an annual basis. The insurer maintains a fully staffed, well-qualified actuarial department Actuarial analysis is subject to a peer review process. Management receives regular reports on claim liabilities (including IBNR) by line or class of business, as well as other key ratios, and reviews unusual fluctuations on a timely basis to review claim liabilities for adequacy.	background and responsibilities of the insurer's actuarial department staff or independent actuaries. If performed in-house, review and test the actuarial peer review process and related sign-offs. Verify management review of contract claim liabilities reporting, including analysis of fluctuations, and test the operating effectiveness of procedures in place.	assumptions. Verify whether the assumptions surrounding contract claim liabilities are in accordance with the relevant SSAPs, as well as applicable statutes, regulations, pronouncements and/or bulletins. Utilize the insurance department actuary or an independent actuary to perform an independent calculation/estimate of the life reserves and incurred but not reported (IBNR) contract claims liability. Determine whether the appropriate disclosures have been made in the Notes to the Financial Statements for any changes in reserve methodologies. Review actuarial reports and compare reports to prior periods. Investigate significant variations. Review correspondence related to any peer reviews performed for appropriate depth of review.
The assumptions used by the insurer to calculate reserves for policies subject to	RV	VA AC PD	RA	The company utilizes the prescribed valuation assumptions of the Valuation Manual to	Utilize a Department actuary, independent actuary or NAIC Actuarial Modeling support staff to	Utilize a Department actuary, independent actuary or NAIC Actuarial Modeling support staff to

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
Principle-Based Reserving are not accurate or appropriate.				calculate PBR reserves. The company has established a process for determining appropriate margins. The company maintains credible experience data to support all assumptions utilized in PBR reserving, including: • Lapse • Mortality • Morbidity • ~~Interest rate~~ • Premium Persistency • Etc.	review company documentation that provides support for assumptions and evidence that they are developed in accordance with the requirements of PBR as published in the Valuation Manual.	verify and validate that the company has followed the requirements of PBR as prescribed in the Valuation Manual in developing assumptions.
The assumptions used by the insurer to calculate reserves for long-term care insurance (LTCI) policies are not accurate or appropriate to meet reserve adequacy requirements.	RV	VA AC	RA	The company maintains credible experience data to support all assumptions utilized in calculating reserves for LTCI policies, including: • Lapse • Mortality • Morbidity • Interest rate • Etc. The company utilizes an independent actuarial firm (other than its appointed actuary) to periodically review its LTCI reserving assumptions.	Select a sample from experience studies to verify support for and consistency with assumptions used by the company. Review any third-party actuarial work to verify and substantiate the appropriateness of company assumptions.	Utilize the insurance department actuary or an independent actuary to review assumptions and methodologies for reasonableness, appropriateness, accuracy, and compliance with the *Valuation Manual.* Compare actual investment, mortality, morbidity, and lapse experience to assumptions. Compare reserving assumptions to rate increase assumptions, (for example review the AG51 filing and

Commented [HB2]: New risk and related procedures to incorporate consideration of long-term care insurance policies

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
						compare against rate increase requests) to ensure that assumptions used for pricing and reserving are similar in nature. Review the company's AG51 filing and compare assumptions utilized by the company in LTCI reserving against industry standards and those of its competitors. Review the company's AG51 reporting to identify assumptions underlying the asset adequacy testing memorandum that appear to be an outlier and compare against a subsequent rate increase filing. Coordinate with the Valuation Analysis Working Group of the NAIC regarding any reviews it has performed on the company's AG 51 filings. Utilize the insurance department actuary or an independent actuary to evaluate the impact that a change in assumptions could have on the company's LTCI reserves and the company's solvency position by reperforming reserve calculations using

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
						more conservative assumptions.
Policies with supplemental or accelerated benefits have not been properly separated and reserved for in accordance with SAP.	OP RV	AC	RA RD	The insurer has a process in which supplemental and accelerated benefits are properly identified and reserved.	Test the process surrounding the identification and reserving of supplemental and accelerated benefits.	Utilize the insurance department actuary or an independent actuary to perform an independent calculation of the reserves of supplemental and accelerated benefits. Verify that reserves are in accordance with SAP.
Policies subject to Principle-Based Reserving are not properly identified or exclusion testing is not appropriately conducted.	RV	VA AC PD	RA	Company conducts and reviews exclusion testing in accordance with Valuation Manual instructions.	Review company support and supervisory sign-off for exclusion testing.	Utilize a Department actuary, independent actuary or NAIC Actuarial Modeling support staff to conduct or reperform exclusion testing.
The life, A&H and deposit-type reserve and IBNR contract claim liability computations are not performed correctly or the selected estimates are unreasonable.	OP RV	AC VA	RA	The insurer has 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. Senior management uses internal or independent actuaries to conduct reserve analyses of all major lines on an annual basis.	Review the process in place (which may include performance of a walkthrough) to estimate the life reserves. Review the credentials, background and responsibilities of the insurer's actuarial department staff. Obtain actuarial reports to verify whether the insurer is using independent or in-house actuaries to perform the reserve calculations on all major lines of business annually and verify senior management review of	Utilize the insurance department actuary or an independent actuary to perform an independent estimate of the life reserves and IBNR contract claims liability. Perform analytical procedures to review the reasonableness of reserve calculations.

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				The actuarial calculations are subject to a peer review process. The insurer's board of directors (or committee thereof) receives an annual presentation on the actuarial analysis process. Management receives regular reports on key ratios and reviews unusual fluctuations on a timely basis to review reserves for adequacy.	reports from actuaries. If performed in-house, review and test the actuarial peer review process and related sign-offs. Review the meeting minutes of the board of directors (or committee thereof) to verify whether a presentation was given on the actuarial calculation process. Verify management review of reserve reporting and test the operating effectiveness of procedures in place.	
The methodologies utilized in PBR are not appropriate or the reserve computations are not performed correctly.	OP RV	AC VA	RA	The company has a formal process in place to develop and validate a model for use in PBR. Governance of the actuarial model includes consideration of: • Security Process • Software Change Process • Parameter Setting Process • Validation Process • Oversight of Overall Model Processes	Review evidence that the company followed its process in developing and validating its model for use in PBR. Review the credentials, background and responsibilities of the insurer's actuarial department staff in developing and validating the model used in PBR.	Utilize a Department actuary, independent actuary or NAIC Actuarial Modeling support staff to review and evaluate results (e.g. compare results of the standard portfolio, reasonableness in comparison with prior periods, etc.) of the insurer's modeling computations. Utilize a Department actuary, independent actuary or NAIC Actuarial Modeling support staff to recalculate reserves on selected policies.

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				Model results have undergone peer review and are subject to reasonableness tests, such as: • The insurer manually calculates Net Premium Reserve (NPR) on selected policies. • The insurer does movement analysis ~~compares~~ comparing reserves per 1000 of face amount with prior periods. • The insurer performs sensitivity testing on key non-prescribed assumptions.	Ensure that company peer review process is in place and operating effectively.	
The computation of reinsurance credits within life, A&H and deposit-type reserves are not performed correctly. (See also Examination Repository – Reinsurance Ceding Insurer.)	CR RV	AC VA CO	RA RRC	The reserving actuary calculates the reserve on a gross basis and determines the net basis by estimating the reinsurance credits and applying them to the gross reserve. The insurer applies reinsurance credits to life reserves by reviewing reinsurance treaties in place at the insurer, as well as	Test the operating effectiveness of the insurer's process for reviewing the reserve analysis to determine whether life reserves have been estimated on a gross basis, including management approval and sign-off. Test the operating effectiveness of the insurer's process to estimate reinsurance credits for life reserves, including	Compare the annual financial statement net and gross incurred for consistency with reinsurance treaties in place at the insurer. Consider the reasonableness of reinsurance credits taken, based on a review of the insurer's reinsurance program and treaties in

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				historical results.	management approval and sign-off.	place. Compare the corresponding reserve held by the reinsurer with the credit taken by the insurer and identify all reasons for differences.
The insurer does not properly adjust the terminal reserve computation back to the reporting date.	OP RV	AC VA	RA	The insurer has a process in place whereby reserve computations are adjusted back to the reporting date.	Test the key controls surrounding the process by which reserve computations are adjusted back to the reporting date.	Utilize the insurance department actuary or an independent actuary to perform an independent estimate of the reserve adjustment back to the reporting date.
The initial reserves calculated by the actuary do not adequately reflect reserve liabilities.	OP RV	AC VA	RA	The insurer has a process in place by which it computes an asset adequacy test on the calculated life reserves. The insurer has a process in place to ensure that the correct assumptions and methodologies are used to estimate the adequacy of the life reserves. Management reviews the asset adequacy test for reasonableness of the reserve amount.	Test the key controls surrounding the process by which the reserve adequacy test is calculated. Test the key controls surrounding the assumptions and methodologies used to estimate reserve adequacy. Verify management review of asset adequacy test.	Utilize the insurance department actuary or an independent actuary to perform an independent estimation of the reserve adequacy test to determine whether the overall reserve liability is adequate.
Management books reserves that are materially different than the actuary's best estimate.	OP ST LG	VA ~~PD~~ AC	RA	The insurer has a process in place to ensure that reserves are recorded based on the actuary's best estimate, or documents an appropriate reason for any deviations. The board of directors (or	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. Review meeting minutes of	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. Review the documentation

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				committee thereof) compares the booked reserves to the amounts included in the actuarial report by receiving a report from the appointed actuary. The insurer's organizational structure limits the influence that management can have on the appointed actuary.	the board of directors (or committee thereof) for evidence of a presentation and review of the actuarial report. Interview the appointed actuary during the planning phase of the examination to determine whether the insurer's organizational structure is appropriate in this area.	supporting a deviation from the actuary's best estimate for reasonableness, if applicable.
The insurer is not properly accounting for cash surrender value (CSV) on life (including annuities) contracts.	OP LG	OB/OW ~~PD~~ VA	RA	The insurer has policies in place to ensure the reporting of CSV on life (including annuities) contracts in accordance with SSAP No. 51.	Ensure the policies for the process used to report CSVs on life (including annuities) contracts is periodically reviewed and approved by management.	For a sample of life (including annuities) contracts with cash surrenders, determine whether the CSV is being properly reported.
Contract claim liabilities are not established or reviewed in accordance with the insurer's standards and applicable statutory guidelines.	RV OP ~~CR~~ LG	AC VA CO	RA	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, applicable statutory guidelines and within a specified time frame. Committees evaluate and strategize claim liabilities involving large or unusual loss contract claim determinations and/or	Obtain documentation supporting the insurer's contract claim liability policy to ensure actuary review and policy adequacy. For a sample of contract claim liabilities, determine whether contract claim reviews were performed and documented in accordance with the insurer's policy and applicable statutory guidelines. Obtain minutes and other meeting materials from the meetings of the committee to determine whether the committee provided	For a sample of contract claim liabilities, verify that the calculation is in accordance with the insurer's policy, applicable statutory guidelines, and are calculated on a timely basis. From the sample selected above, identify any claims included on the detail for which the liability recorded is not consistent with the contract terms. Identify claims that appear to have not been paid in a reasonable or fair time frame. Investigate the status of these claims/benefits with the insurer's

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				settlements.	appropriate oversight.	management.* Verify that the claims/benefits liability is complete and properly recorded at year-end. Obtain a detail of resisted claims and claims closed without payment. Perform procedures to verify the grounds for the resisted claims. For a sample of contract claim liabilities meeting the criteria to go to a loss/benefits committee, determine whether the liabilities were referred to this committee.*
The insurer does not maintain an adequate ~~premium~~ deficiency reserve.	RV ~~RQ~~ OP	VA CO CM	RA	The insurer has a process in place to review for premium deficiencies on an annual basis in accordance with SSAP No. 54. Independent actuaries review and sign off on deficiency reserve calculations.	Review the process in place and verify key controls surrounding the calculation of premium deficiency reserves. Obtain the actuarial opinion and verify approval of deficiency reserve calculations.	Perform an analytical review of loss ratios. If necessary, utilize the insurance department actuary or an independent actuary to perform a detailed review or an independent calculation/estimate of the premium deficiency reserves.

EXAMINATION REPOSITORY – UNDERWRITING

Annual Statement Blank Line Items

There are no Annual Statement line items directly related to the underwriting process; however, policies underwritten and rate calculations may impact line items associated with areas such as premiums and reserves.

Relevant Statements of Statutory Accounting Principles (SSAPs)

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

No. 6 Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due from Agents and Brokers (*All Lines*)
No. 51R Life Contracts (*Life Companies*)
No. 53 Property Casualty Contracts – Premiums (*P&C Companies*)
No. 54R Individual and Group Accident and Health Contracts (*Health Companies*)
No. 65 Property and Casualty Contracts (*P&C Companies*)

--Detailed Eliminated to Conserve Space--

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
Other Than Financial Reporting Risks						
The company has not established appropriate rates for its long-term care insurance (LTCI) policies	ST PR/UW	Other	UPSQ	The insurer utilizes a fully staffed, well-qualified actuarial pricing function that has significant experience and expertise in LTCI. The company conducts experience studies and utilizes credible data as the basis for its rate assumptions. The company files accurate and complete rate increase requests with all departments in a timely manner.	Review the credentials, background and responsibilities of the insurer's actuarial pricing function for appropriateness. Select a sample from experience studies to verify support for and consistency with rate assumptions used by the company. Communicate with department staff in charge of LTCI rate review requests (in multiple states if appropriate) to assess the quality and timeliness of the insurer's rate requests.	Perform analytical procedures to review the insurer's profitability and history of indicated rates vs. selected/filed rates to evaluate the sufficiency of premium rates. Compare the premium rates utilized by the insurer to industry averages and those of competitors (if known) for reasonableness. If rates have been subject to insurance department approval, consider whether reliance can be placed on this work. If deemed necessary, utilize the insurance department actuary or an independent actuary to perform a review or independent calculation of premium rates. Compare rate increase assumptions to reserve assumptions, (for example review the rate requests and compare against AG51 filings) to ensure that assumptions used for pricing and reserving are similar in nature. Track the progress of the company in achieving its

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
						rate increase goals by comparing rate increases received against those requested.

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. Similar considerations apply if a state has adopted Model Regulation 787 which supersedes

AG 48 and applies a principle-based methodology to those policies that AG 48 would have otherwise applied to.

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 assumptions are higher than what the insurer can expect to realize from medically underwritten insurance policies. The interest rate assumptions are intended to be significantly lower than current money and capital market yields. Thus, the life reserves developed are generally conservative.

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

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

1. Ordinary Life Reserves

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

2. Group Life Reserves

   Most group life insurance is monthly renewable term insurance. For these policies, gross premiums are typically recalculated periodically, most often annually, using the age and sex census of the group along with experience adjustments. Therefore, the reserve is usually calculated as the unearned 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.

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. Detailed guidance for requirements for life reserves relating to riders is found in Section II of the Valuation Manual.

6. Miscellaneous Life Reserves

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

7. Minimum Aggregate Reserves

   In the aggregate, policy reserves for all life insurance policies valued under a formula based valuation methodology that are reported in the statutory financial statements must equal or exceed reserves calculated by using the assumption and methods that produce the minimum formula standard valuation.

C. Principle-Based Valuation Methodology

In general, under a principle-based valuation methodology, all of the liability cash flows emanating from the contract benefits provided in the product are determined for each period and compared with all of the asset cash flows for each period determined from the assets the insurance company has purchased or plans to purchase or sell to fund the liability cash flows. The resulting differences between the asset and liability cash flows for each period are valued under a range of likely or plausible economic scenarios.

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

The stochastic reserve under a principle-based valuation methodology is determined as a function of the discounted value of the differences between the asset and liability cash flows for each period over the range of economic scenarios. Economic scenarios may consist of interest rates or market returns or both depending on the nature of the asset and liability cash flows. A single economic scenario represents multiple consecutive periods (such as 30 or 40 years) of movements in the underlying interest rate or market rate returns. The length of the scenario period is determined by the length of the liabilities being valued. The economic scenarios are stochastically (randomly) generated using a prescribed Economic Scenario Generator (ESG). The prescribed ESG can be found on the Society of Actuaries website. The objective is to determine if there is a reasonable likelihood that assets are insufficient to cover the obligations of the company, and by what amount they may be insufficient. Under economic scenarios where assets are insufficient, the principle-based methodology determines all the amounts of the insufficiencies and discounts them back to the valuation date. The largest discounted value is known as the Greatest Present Value of Accumulated Deficiencies, or “GPVAD”, for that scenario. The stochastic reserves may be set at a CTE(70) level (conditional tail expectation at the 70% level). The function CTE(70) means the average of the 30% (100%-70%) worst (largest) GPVADs. So for example if a company randomly generates 1,000 economic scenarios, it would then determine the largest accumulated amount of deficiency for each of the 1,000 scenarios. The CTE(70) stochastic reserve level would be determined by taking the average of the 300 [1,000 x (100% - 70%)] worst GPVADs out of the 1,000 scenarios.

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

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

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

D. Actuarial Opinion and Asset Adequacy Analysis

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

E. Actuarial Oversight and Internal Controls

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

1. The Board of Directors should:

    a. Receive and reviews reports, including the certification of the effectiveness of internal controls with respect to the principle-based calculation, as provided in Section 12.B.(2) of the Standard Valuation Law.
    b. Understand the process undertaken by senior management to correct any material weaknesses in the internal controls with respect to a principle-based reserve valuation, if any is identified.
    c. Understand the infrastructure (consisting of policies, procedures, controls and resources) in place to implement and oversee principle-based reserve processes.
    d. Ensure the proper documentation of review and action undertaken by the board relating to the principle-based reserving function in the minutes of all of the board meetings where such function is discussed.

2. Senior Management should:

    a. Ensure that an adequate infrastructure (consisting of the risk tolerances, policies, procedures, controls, risk management strategies and resources) has been established to implement the principle-based reserving function.
    b. Review for reasonableness the principle-based reserving elements (consisting of the assumptions, methods and models used to determine principle-based reserves of the insurer company or group of insurance companies) that have been put in place.
    c. Review the principle-based reserving results for consistency with established risk tolerances of the insurance company or group of insurance companies in relation to the risks of the products of the insurance company or group of insurance companies offers, the various strategies used to mitigate such risks, and its emerging experience, in order to understand the general level of conservatism incorporated into principle-based reserves.
    d. Review and address any significant and/or unusual findings in light of the results of the principle-based reserve valuation processes and applicable sensitivity tests of the insurance company or group of insurance-

companies.

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.

F. Long Term Care Insurance (LTCI) Reserves Overview

Commented [HB1]: Revisions to incorporate long-term care insurance considerations

Long-Term Care Insurance (LTCI) provides coverage for the cost of long-term care services in the event that an insured becomes unable to perform a specified number of activities of daily living (ADL) (e.g. dressing, bathing, eating, etc.). Historically, insurers that wrote LTCI encountered difficulties accurately projecting claims costs, lapse rates, investment returns and other factors associated with LTCI, and subsequently many writers have experienced unprofitability in older (legacy) blocks of LTCI business. This has led many companies to request significant rate increases, offer policyholders the option of modifying product benefits, or exit the product line altogether.

As many insurers continue to experience significant solvency challenges related to this line of business, state insurance regulators should continue to carefully evaluate and monitor the solvency position of all insurers with a material amount of LTCI business. As some insurers look for avenues to minimize or eliminate its risk from the LTCI block, they may look to new reinsurance opportunities and non-traditional buyers.

These same risks also affect reinsurers because the reinsurance contract cannot arbitrarily allow for ceded premium increases. Additionally, in order to effectuate a true transfer of risk, the reinsurer does not have the ability to require the direct writer to request rate increases. Furthermore, it would not qualify for reinsurance accounting.

In addition, periods of economic downturn and low interest rates increase the risk that LTCI writers will be challenged to generate sufficient returns to support this line. Declines in projected investment returns could also have a significant impact on LTCI reserve assumptions.

1. Actuarial Guideline 51—The Application of Asset Adequacy Testing to Long-Term Care Insurance Reserves (AG 51)

   Effective for reserves reported with the Dec. 31, 2017, financial statement, Actuarial Guideline 51—The Application of Asset Adequacy Testing to Long-Term Care Insurance Reserves (AG 51) now applies. The *Health Insurance Reserves Model Regulation* (#10) and the NAIC *Valuation Manual* VM-25, Health Insurance Reserves Minimum Reserve Requirements, contain requirements for the calculation of LTCI reserves. AG 51 is intended to provide uniform guidance and clarification of requirements for the appropriate support of certain assumptions for the asset adequacy testing applied to a company's LTCI block of contracts. AG 51 requires reporting to the department within the appointed actuary's actuarial memorandum required by VM-30, Actuarial Opinion and Memorandum Requirements, or in a special actuarial memorandum containing LTCI-specific information on the results of the analysis, assumptions on mortality, voluntary lapse, morbidity, investment returns and rate increase assumptions.

2. Reserve Increase Factors

   a. Background

   Ever since asset adequacy testing became a requirement for life insurers in the 1980s, actuaries have been required to analyze reserve adequacy assumptions on an annual basis and make the assumptions more conservative when experience or expectations become more adverse. If the more conservative assumptions resulted in inadequate reserves, companies were required to establish higher reserves to ensure future claims could be paid in the more adverse environment.

In some cases, the chain of events is straightforward. For instance, for life insurance, if more people die at earlier ages than expected and the experience is highly credible, then the actuary increases mortality rates in the upcoming year-end filing. This leads to higher reserves being established.

In other cases, the chain of events is less straightforward. For instance, it is expected that cash surrenders on deferred annuity products will increase if interest rates rise. However, most deferred annuities have been sold during a period of decreasing interest rates. Actuarial and regulatory practice require reserves to be adequate in moderately adverse conditions, even if those conditions have not been recently experienced. There is typically judgment by the company actuary and another layer of judgment by regulators in play in this type of complex situation. The NAIC Standard Valuation Law Model 820 (SVL), NAIC Valuation Manual (VM), and the Actuarial Standards Board's Actuarial Standards of Practice (ASOPs) describe how these complex situations should be handled.

b. Long Term Care Insurance

LTCI blocks of business experiencing higher morbidity than expected will likely lead to changes in expectations on future morbidity for both the observed block and other blocks.

With LTCI, some factors are likely to play out in a straightforward manner. For instance, a combination of higher life expectancy and lower lapses will lead to more people than expected reaching prime LTCI claims ages of 80 and above. This leads to companies holding higher reserves than originally anticipated. Similarly, companies experiencing a decreasing interest rate environement will have lower-than-expected investment returns. This leads companies to hold higher reserves as the investment income relied upon to help pay claims is diminished.

It is important to note that mortality, lapse, and interest rate factors become observable and credible during the later premium-paying years.

c. Morbidity Assumptions

Morbidity, however, has tended to fall into the category of a complex factor. The three main aspects of LTCI morbidity are: (1) incidence, the percentage of people at a given age who start a claim; (2) average length of claim; and (3) utilization, which is less than 100 percent if, for example, the daily nursing home cost is lower than the maximum daily benefit in the insurance policy.

There has not been uniform experience development in morbidity, except that length of claim has tended to increase. This is likely because cognitive (e.g. dementia and Alzheimer's) claims tend to be longer than average and incidence has been higher than expected, which may be due to more people reaching the age when cognitive claims tend to occur.

Because of divergent experience among companies and because morbidity becomes observable and credible during the later claim-paying years, establishing and regulating LTCI morbidity assumptions has not been straightforward. However, as with other factors and other products, the handling of these situations is addressed in the SVL, VM, and ASOPs. Examples of these standards include:

- SVL Section 12A(3)(a): "Assumptions shall, to the extent that company data is not available, relevant, or statistically credible, be established using other relevant, statistically credible experience."

- SVL Section 12A(4): "Provide margins for uncertainty … such that the greater uncertainty the larger the margin and resulting reserve."

- Actuarial Guideline 51 (providing guidance on VM-30) Section 4.B.: "The analysis shall comply with applicable Actuarial Standards of Practice, including standards regarding identification of key risks. Material assumptions associated with the LTCI business shall be determined testing moderately adverse deviations in actuarial assumptions."

- Acounting Practices and Procedures Manual, Appendix A-010 paragraph 48.e (referenced in VM-30): "The total contract reserve established shall incorporate provisions for moderately adverse deviations."

- Acounting Practices and Procedures Manual, Appendix A-010 paragraph 51 (referenced in VM-30): "Annually, an appropriate review shall be made of the insurer's prospective contract liabilities… and make appropriate increments… if such tests indicate that the basis of such reserves is no longer adequate."

The result is that whether credible experience exists or not, the company actuary needs to set assumptions underlying reserves, and the factors underlying the assumptions are often complex and frequently changing. Company and regulatory actuaries are experienced in working in this complex, changing environment with many life insurance products, such as variable annuities, indexed products, and LTCI having product features and factors underlying reserves that are complex and changing.

d. Rate Increases

A unique aspect of LTCI products is being a long-term product with rate increases that require review by states. Besides states with the largest insurance departments, the actuaries reviewing LTCI reserves are often the same staff reviewing LTCI rate increases. For larger states, there is typically coordination or training to ensure the reserve and rate teams are on the same page regarding developments in for example, life expectancy and morbidity. State insurance regulator experience in reviews of LTCI reserves and rate increase filings show that factors resulting in reserve increases and requests for rate increases are similar and include higher life expectancy, lower lapses, lower investment returns, and worsened morbidity.

There has been additional regulatory attention on ensuring that the companies asking for rate increases based on adversity of certain factors are holding reserves based on at least the same level of adversity in those factors. The questions used in many states' rate increase reviews require the company to explain the consistency between the rate increase filing assumptions and reserve adequacy assumptions.

To date, the most common complex, non-straightforward case is the applicability of a company's adverse morbidity experience of an older LTCI block to morbidity assumptions on a newer block. This complex dynamic comes into play when establishing reserve and rate increase assumptions.

The reserve assumption changes can occur with initiation by the company, through formal or informal agreement between regulators or companies, or by relying on SVL Section 11.6., which allows a commissioner to require a company to change reserve assumptions and adjust reserves.

A typical example of a chain of events would first involve a block issued in 1995 to 1998 to policyholders with issue ages ranging from 52 to 62. By 2019, enough policyholders have reached prime LTCI claim ages of 80+, that experience driving reserve assumption changes has developed. As policyholders enter ages in the upper 80s and 90s, additional experience will develop that will help predict future LTCI costs and result in further changes in reserve assumptions. The development of older-age morbidity experience is expected to generate volatility in LTCI reserves. For some companies, the older-age morbidity experience will likely be unfavorable, with increased reserves needed. For most other companies, the older-age morbidity experience will likely be as expected, leading to no significant, unforeseen reserve increases.

Companies will be expected to apply lessons learned from older blocks of business to their newer blocks of business. Those lessons will likely differ by situation. For example, to the extent underwriting is different, the newer and older blocks may experience different morbidity trends.

e. Rate Increase Factors

All of the above-mentioned reserve-related dynamics have occurred, are occurring, or will occur with rate increase requests. Historically, rate increases were based on higher life expectancy, lower lapses, and lower investment returns. As morbidity experience has developed, regulators have started receiving more morbidity-driven LTCI rate increase requests.

As the credibility of morbidity experience on older blocks increases, consideration is given to the applicability of the older-block data to newer blocks. This consideration is required with reserves and can drive substantial reserve increases in the industry. The same consideration can also drive rate increase requests, in some cases before prime claims years begin on the newer LTCI block.

To assist state insurance department staff performing reserve valuation analysis to gain an understanding of the rate review process, communication and coordination with the rate review staff may be necessary. The following example describes how lessons learned on an older block's morbidity experience and/or the need for more credible experience on the newer blocks may factor into a rate increase review.

- Three potential approaches for regulatory consideration of such rate increases are, (1) disapprove the rate increase and force the new block to have credible experience before approving an increase, (2) allow partial consideration of the "lessons learned" on the older block and partially approve the rate increase, or (3) allow full consideration of the older-block lessons learned and fully approve the rate increase.

- The downside of option (1) is that it will lead to higher rate increase requests in the future if newer block experience plays out similarly to older block experience. The downside of option (3) is that rates would end up being too high if experience plays out more favorably than expected.

- After multiple, public, regulatory actuarial discussions on the topic, general (but not unanimous) consensus was that most rate approvals should land in a spot between options (2) and (3). To the extent the rate increase approval is towards option (3), the department should ensure the company has a mechanism to lower future premium rates if experience plays out more favorably than expected.

f. Intra-Department Communication and Coordination of Actuarial Review Work

While every state insurance department may be structured differently, many state insurance departments have the same staff members perform work on both LTCI reserve valuation analysis and rate increase reviews. For state insurance departments that have separate staff performing these functions, department staff should be aware of or coordinate the intra-department review work related to each function.

As examiners perform both the Corporate Governance assessment and the examination interviews, the topics discussed in this section should be considered. Exhibit Y – Examination Interviews includes several questions which may be considered as part of that process. Additionally, procedures regarding the examiners' assessment of the insurer's long-term care insurance related risks, controls, and possible test procedures can be located in Section 3 Reserves/Claims Handling (Life) repository and Underwriting repository.

EXHIBIT M
UNDERSTANDING THE CORPORATE GOVERNANCE STRUCTURE

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

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

1. Are individuals within the insurer's actuarial function suitable for their respective roles? Do they possess the necessary competence and integrity for their positions?
    a. Does the insurer's appointed actuary maintain current an Accepted Actuarial Designation and ~~actuarial credentials with an appropriate professional organization (e.g., FCAS, MAAA, etc.)~~ otherwise meet the definition of a Qualified Actuary, as stated in the NAIC Statement of Actuarial Opinion Instructions?
    ~~b. Does the appointed actuary have experience in the lines of business written by the company?~~
    ~~c. Do others within the company's actuarial function have the appropriate knowledge, experience and background to function in the roles assigned to them?~~
    b. If the company has an internal actuarial function, is it appropriate for the company's size, complexity, and lines of business written?
        i. Do those within the company's actuarial function have the appropriate knowledge, experience, and background to function in the roles assigned ot them?
        ii. Does the organizational chart indicate appropriate lines of reporting for the actuarial function?
    c. If the company outsources any part of its actuarial function, is it appropriate for the company's size, complexity, and lines of business written?
        i. Has management determined that the actuary has the appropriate knowledge, experience, and background to function in the assigned role?
        ii. What oversight is the company performing, and who at the company is responsible for this task?

Commented [HB1]: Revisions proposed by AOWG/CASTF (Section D: Assessing Management)

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

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

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.).
- If the company writes long-term care insurance, consider the following questions:
  - Describe how applicable actuarial guidelines (e.g., Actuarial Guideline 51) impact the company's rates and reserves.
  - Describe the relationship between the actuarial assumptions used in rate filings versus those used for annual statement reporting. Explain any difference in assumptions, if applicable.
  - Describe the relationship between the actuarial assumptions underlying projections versus those used in asset adequacy analysis. Explain any difference in assumptions, if applicable.
  - Describe plans for future rate increase requests and/or the status of current rate requests.

Corporate Strategy

- Give a general description of the company's reserving philosophy.
- Explain what types of tools or reports you utilize to evaluate actuarial decisions.

Other Topics

- What is the quality of the actuarial report, with respect to completeness and clarity of documentation?
- What actions have been taken to apply PBR methodologies? (*Life Insurers Only*)
  - How are system capabilities considered in preparation for PBR implementation?
  - What system changes were made to apply PBR?
  - How are staffing needs, appropriate expertise and availability of effective training evaluated in preparation for PBR implementation?
  - What changes to staffing and training were made to apply PBR?
  - Discuss management's commitment to successful implementation of PBR.

