FINANCIAL EXAMINERS HANDBOOK (E) TECHNICAL GROUP
Conference Call
Thursday, November 14, 2019
2:00 p.m. ET/ 1:00 p.m. CT

ROLL CALL

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<th>Name</th>
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<th>Other Name(s)</th>
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<tbody>
<tr>
<td>Susan Bernard</td>
<td>California</td>
<td>Joel Bengo/Peter Rao</td>
<td>Nevada</td>
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<td>Richard Ford</td>
<td>Alabama</td>
<td>Colin Wilkins</td>
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<td>William Arfanis</td>
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<td>New Jersey</td>
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<td>N. Kevin Brown</td>
<td>District of Columbia</td>
<td>Tracy Snow</td>
<td>Ohio</td>
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<td>Cindy Andersen</td>
<td>Illinois</td>
<td>Joel Sander</td>
<td>Oklahoma</td>
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<td>Grace Kelly</td>
<td>Minnesota</td>
<td>Melissa Greiner</td>
<td>Pennsylvania</td>
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<td>Levi Nwasoria</td>
<td>Missouri</td>
<td>Patrick McNaughton</td>
<td>Washington</td>
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<td>Justin Schrader</td>
<td>Nebraska</td>
<td>John Litweiler</td>
<td>Wisconsin</td>
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<td>NAIC Support Staff:</td>
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<td>Bailey Henning</td>
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AGENDA

1. Consider Adoption of September 12, 2019 Financial Examiners Handbook (E) Technical Group call minutes—*Susan Bernard (CA)*

2. Consider Adoption of Handbook Guidance—*Susan Bernard (CA)*
   - Financial Analysis (E) Working Group Referral and Proposed Revisions Related to Troubled Insurance Companies
     - Interested Party Comment Letter
   - Proposed Revisions to Enhance Exhibit V – Overarching Prospective Risk Assessment & Exhibit AA – Summary Review Memorandum

3. Review 2019 Projects—*Bailey Henning (NAIC)*

4. Receive Update on IT Examination (E) Working Group Projects—*Miguel Romero (NAIC)*

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

6. Adjournment
Financial Examiners Handbook (E) Technical Group
Conference Call
September 12, 2019

The Financial Examiners Handbook (E) Technical Group of the Examination Oversight (E) Task Force met via conference call Sept. 12, 2019. The following Technical Group members participated: Susan Bernard, Chair, and Laura Clements (CA); Richard Ford (AL); William Arfanis (CT); N. Kevin Brown (DC); Grace Kelly (MN); Levi Nwasoria (MO); Lindsay Crawford (NE); Colin Wilkins (NH); John Sirovetz (NJ); Joel Bengo (NV); Tracy Snow (OH); Jamille Jaffurs (OK); Melissa Greiner (PA); John Jacobson (WA); and John Litweiler (WI).

1. **Adopted Handbook Guidance**
   a. **Salary Range Guidelines**

Ms. Bernard said the Risk-Focused Surveillance (E) Working Group referred proposed revisions regarding salary range guidelines for the Technical Group to consider. The proposed salary range guidelines were developed based on a survey of the states, as well as research to understand compensation practices in similar job roles, such as public accounting, private industry and other areas of financial regulation.

To avoid causing undue burden to the states using the existing salary and per diem guidance within the *Financial Condition Examiners Handbook* (Handbook), the Working Group recommends that the existing guidance be retained, with explanatory language describing its purpose and expectations. The Working Group also recommends that each set of salary guidelines be maintained, with annual updates to the existing salary and per diem guidelines and biennial updates to the proposed salary range guidelines.

Ms. Bernard said no comment letters were received regarding this proposed change.

b. **Interviews**

Ms. Bernard said NAIC staff developed proposed revisions to address a referral received in 2018 from the Risk-Focused Surveillance (E) Working Group regarding takeaways from the 2018 Exam Peer Review sessions. These revisions attempt to emphasize the importance of customizing questions that are asked during C-level interviews in examination planning. The proposed revisions also suggest that the chief risk officer be among the first C-level individuals to be interviewed, when possible, as the information obtained through that interview can help inform subsequent interviews. NAIC staff also developed a new template for interviewing a chief marketing officer. This template provides possible questions that the exam team may consider when conducting this interview.

Ms. Bernard said two comment letters were received regarding these proposed changes. Ms. Clements said the comment letter that California submitted suggested additional language to clarify that information obtained during each interview could be used to tailor subsequent interviews. Ms. Bernard said these suggestions were incorporated as friendly amendments.

A comment letter that Tom Finnell (America’s Health Insurance Plans—AHIP) submitted suggested additional language to clarify specific questions on the interview template for the chief marketing officer. These minor revisions were accepted as friendly amendments. Ms. Bernard said that other comments provided in the letter related to items already covered in other sections of the Handbook and, therefore, were not incorporated. Mr. Finnell thanked the Technical Group for considering the comment letter provided.

Mr. Arfanis made a motion, seconded by Mr. Nwasoria, to adopt the guidance related to salary range guidelines and C-level interviews (Attachment One). The motion passed unanimously.

2. **Exposed Handbook Guidance**
   a. **Troubled Insurance Companies**

Ms. Bernard said NAIC staff developed proposed revisions to incorporate considerations when examining a troubled or
potentially troubled insurance company in response to a referral from the Financial Analysis (E) Working Group. The proposed revisions provide guidance regarding specific key elements from the Troubled Insurance Company Handbook, including communication expectations for companies that are troubled or potentially troubled, and pre-receivership considerations. Ms. Bernard said the referral also requested consideration of guidance regarding the priority rating framework. However, because existing guidance addresses the priority framework, no additional changes were made.

b. Management Letters

Ms. Bernard said NAIC staff developed proposed revisions to guidance for management letters in response to a referral from the Chief Financial Regulator Forum. The proposed revisions clarify that there may be circumstances in which the insurance department provides the management letter to a different level within the holding company structure. Situations when this may be appropriate include when the examination team wishes to issue a group management letter covering multiple entities and when a board of directors with members independent of management exists above the legal entity level.

Ms. Bernard said the referral also requested that the Technical Group consider whether the management letter issued as part of a financial examination should be proactively shared among the states using the Financial Exam Electronic Tracking System (FEETS). Ms. Bernard said that FEETS implementation is pending and asked NAIC staff to continue to monitor the status of implementation.

c. Exhibit V – Prospective Risk Assessment and Exhibit AA – Summary Review Memorandum

Ms. Bernard said the referral regarding 2018 Exam Peer Review takeaways also suggested that the Technical Group consider the format of Exhibit V – Prospective Risk Assessment. The referral indicated that peer review attendees thought the format of the exhibit created confusion and did not appropriately emphasize the importance of the risks that should be addressed using the exhibit. Proposed revisions to the exhibit include revising the columns and column headers to more clearly indicate the expected documentation and aligning the exhibit more closely with the Summary Review Memorandum (SRM) and the Insurer Profile Summary (IPS). The examples provided in the Exhibit were also updated to reflect the proposed format changes. Ms. Bernard said that proposed guidance for the second part of the exhibit clarifies that common areas of concern are included for reference only. Examiners are not required to include risks for each common area of concern, nor are they required to provide a rationale for not identifying a risk for each area of concern. Proposed revisions also include using the Own Risk and Solvency Assessment (ORSA) filing, when available, as a source for identifying potential prospective risks. Ms. Bernard said that Exhibit AA – Summary Review Memorandum was revised to include definitions and considerations for determining the trend and risk assessment level of identified risks.

Mr. Finnell said that examiners may need to engage a specialist to assist in performing some of the procedures that are illustrated within the examples on Exhibit V. He also said that examiners should attempt to test mitigation strategies in place at the insurer before conducting independent testing, as some of the testing can become very specialized and require additional resources. Ms. Bernard agreed that examiners are expected to first gain an understanding of the mitigation strategies and controls in place, and only perform additional independent testing if warranted based on the risk assessment.

The Technical Group agreed to expose the proposed revisions to: 1) Troubled Insurance Companies; 2) Management Letters; 3) Exhibit V – Overarching Prospective Risk Assessment; and 4) Exhibit AA – Summary Review Memorandum for a 30-day public comment period ending Oct. 14.

3. Received an Update on Reserves/Claims Handling Repository Project

Bailey Henning (NAIC) said that a group of volunteers from the Technical Group has now reviewed two of the three reserves/claims handling repositories, using input provided by the Life Actuarial (A) Task Force, the Health Actuarial (B) Task Force and the Actuarial Opinion (C) Working Group. She said the volunteers plan to meet at the end of September to discuss the remaining repository. After each repository has been reviewed, the volunteers expect to meet at least once more before providing a recommendation of changes for the Technical Group to consider. Miguel Romero (NAIC) said that it is possible that this project may extend into 2020.

4. Received an Update on IT Examination (E) Working Group Projects

Mr. Romero informed the Technical Group that the IT Examination (E) Working Group plans to meet via conference call
Sept. 26 to consider adopting revisions related to: 1) language used when documenting the conclusions reached as a result of the information technology (IT) review; 2) considerations when using the work of third parties; and 3) considerations when using company-prepared cybersecurity self-assessments to supplement the IT review. Mr. Romero said that due to the technical nature of the subject matter, the IT Examination (E) Working Group has authority to adopt guidance directly into the Handbook. Therefore, anybody wishing to be part of the discussion should attempt to participate in the upcoming conference call.

Having no further business, the Financial Examiners Handbook (E) Technical Group adjourned.
MEMORANDUM

TO: Susan Bernard, Chair, Financial Examiners Handbook (E) Technical Group, and Judy Weaver, Chair, Financial Analysis Solvency Tools (E) Working Group

FROM: Kevin Fry, Chair, Financial Analysis (E) Working Group

DATE: February 27, 2019

RE: Revisions to Troubled Insurance Company Handbook

The Financial Analysis (E) Working Group (FAWG) is responsible for maintaining and updating the NAIC’s Troubled Insurance Company Handbook (TCH) as a resource for regulator use in monitoring the solvency of troubled or potentially troubled insurers. The TCH is a regulator-only publication that is updated and revised periodically based on actual cases and experiences of regulators in dealing with troubled companies. The TCH was recently revised to incorporate additional content related to communication expectations and pre-receivership considerations. As some of these items have the potential to affect examination and analysis activities of troubled or potentially troubled insurers, FAWG would like to refer some specific items for consideration of incorporation into the NAIC’s Financial Condition Examiners Handbook and Financial Analysis Handbook. Specific elements highlighted in the TCH that may be appropriate to consider include, but are not limited to, the following:

1. **Priority Ratings** – Revised guidance clarifies that solvency monitoring efforts for Priority 1 and Priority 2 insurers under the new NAIC prioritization framework should include consideration of guidance and procedures outlined in the TCH.

2. **Communication** – Enhanced guidance emphasizes the importance of communicating the status and results of ongoing monitoring efforts in a troubled or potentially troubled company situation. Timely communication of significant events should occur within the department, with other impacted departments and with other relevant groups (e.g., other regulators, company, affiliates, guaranty funds) as outlined in the guidance.

3. **Pre-Receivership Considerations** – Revised guidance emphasizes the importance of incorporating pre-receivership considerations into the examination efforts of troubled and potentially troubled insurers. Specific examples include, but are not limited to, understanding the location of and access to company assets, understanding outsourced services (including affiliate services) and evaluating the insurer’s ability to transfer claims data in a useable format in a timely manner. Additional guidance related to possible procedures in this area is also available in the NAIC’s Receivers Handbook for Insurance Company Insolvencies.

In considering these issues, FAWG recommends reviewing existing guidance in the NAIC’s Financial Condition Examiners Handbook and Financial Analysis Handbook to determine whether the issues listed above are adequately addressed. Moreover, we recommend considering whether the formation of a specific section of guidance (or repository) for examining and analyzing troubled or potentially troubled insurers would be beneficial to assist regulators in addressing these issues during financial exams and analysis.

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

Thank you for your consideration.
III. GENERAL EXAMINATION CONSIDERATIONS

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

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

I. Considerations for Potentially Troubled Insurance Companies

A troubled insurance company is broadly defined as an insurance company that is either in or is moving towards a financial position that subjects its policyholders, claimants and other creditors to greater-than-normal financial risk, including the possibility that the company may not maintain compliance with the applicable statutory capital and/or surplus requirements (Troubled Insurance Company Handbook). The “Prioritization Framework” as discussed in the NAIC’s Financial Analysis Handbook identifies troubled companies as Priority 1.

The Troubled Insurance Company Handbook provides a number of insights to assist in enhancing a state’s monitoring and surveillance, and it outlines several regulatory actions available to Departments of Insurance (DOIs). In situations in which an examination is being planned for a troubled insurance company (i.e., Priority 1 company), the NAIC’s Accreditation Program Manual (Part B3: Department Procedures and Oversight) indicates that “the department should generally follow and observe procedures set forth in the NAIC Troubled Insurance Company Handbook.” However, regulators may also consider leveraging the insights in the Troubled Insurance Company Handbook for Priority 2 companies, which are defined in the Financial Analysis Handbook as “high-priority insurers that are not yet considered troubled but may become so if recent trends or unfavorable metrics are not addressed.”

The following guidance provides an overview of key elements to consider during an examination. Additional insights to assist in enhancing a state’s monitoring and surveillance of troubled insurance companies, including regulatory actions available to Departments of Insurance (DOIs), can be found in the Troubled Insurance Company Handbook.

Communication Expectations

If an examination is planned or ongoing for a troubled or potentially troubled company, or through the course of the examination the domestic regulator elevates the priority level of the company to troubled or potentially troubled, it is critical that the domestic regulator communicates proactively and timely with other impacted state insurance regulators. It is also important that the non-domiciliary state communicate with the domestic regulator prior to taking any action against the insurer. This can be particularly important if the corrective action plan implemented by the domestic regulator depends on continued operations of the insurer in other states. Depending on the circumstances, it may also be appropriate to communicate certain information with other parties, such as other regulatory bodies, company management, and state guaranty funds. Establishing a coordinated communication system among the relevant parties will help facilitate the domestic regulator’s surveillance of the troubled company.

The timeliness of communication with other regulators should be commensurate with the severity of the event and should include information about the troubled company’s situation and the proposed corrective action. It may also include a
request for other jurisdictions to assist in implementation of the plan. When determining which states to notify, the department may consider those in which the company 1) has a significant amount of written, assumed or ceded insurance business; 2) has significant market share; 3) is licensed; 4) has affiliates; 5) utilizes fronting entities; 6) has pooled companies; and 7) is seeking to write business or obtain a license. If it is reasonably anticipated that corrective plans will not prevent a finding of insolvency or insolvency is reasonably possible, advance communication to the guaranty funds is critically necessary for a successful transition to liquidation. If the guaranty funds are notified in a timely manner, they may be able to provide additional guidance and assistance in preparing the company for liquidation.

Pre-Receivership Considerations

Depending on the circumstances of the troubled company’s situation, the department may determine that the appropriate course of action is to place the company in receivership. There are several steps the department can take to ensure a smooth transition to receivership, should that be necessary. Having a thorough understanding of the company’s rights and ownership of its assets, as well as its liabilities and obligations can help the department manage the possible transactions that could occur if the company is placed in receivership. It may also help the regulator understand if inappropriate transactions occur in anticipation of receivership, such as preferential payments to related entities and payment of management bonuses or expense reimbursements. As part of the corrective plan, the department may consider requesting implementation of controls surrounding the troubled company’s operations. For instance, it may be necessary for management to establish controls around acceptance of new business or new commitments by the company, as well as recordkeeping requirements if the insurer is involved with reinsurance.

If an examination is planned or ongoing for a troubled or potentially troubled company, the examination should increase its review of risks and controls surrounding financial reporting processes in the areas discussed above. For example, the exam may have a greater focus on the following areas:

- Gaining an understanding of the location (i.e., bank accounts, deposits, custodial accounts, letters of credit, etc.) and ownership (i.e., funds held with reinsurers, intermediaries, MGAs/TPAs, etc.) of company assets;
- Gaining an understanding of possible encumbrances on company assets that may be triggered if the financial position of the company continues to deteriorate;
- Gaining an understanding of the provisions within various agreements that company has entered into (i.e., reinsurance agreements, agreements with service providers, investment advisors, etc.) that could be impacted by being placed into receivership;
- Reviewing transactions involving the movement of company assets;
- Identifying primary responsibility for obligations and liabilities such as tax payments, pension plan contributions, pledges of assets, etc.; and
- Additional testing to ensure the completeness of policy and claims data.

If receivership or liquidation is triggered, and assets are transferred to the receiver or guaranty fund to settle obligations, it is important that the company’s data be maintained in such a format to ensure that policies can continue to be maintained and claims can continue to be paid. For example, the company should have the ability to export its claims data through a defined format (Uniform Data Standards—UDS) that would allow the data to be received and utilized by a third-party guaranty fund. Therefore, the examination may include additional procedures as part of the IT review to identify and locate data storage and processes, understand the format of the data, and ensure proper functionality exists for timely and efficient export of policy and claims data in the event of a receivership.
MEMORANDUM

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

FROM: Pat McNaughton (WA), Chair of the Chief Financial Regulator Forum

DATE: October 26, 2018

RE: Management Letter

As you know, the Financial Condition Examiners Handbook has guidance that indicates the following requirements:

The letter to management or other means of communication as determined by the state, can serve as a vehicle for an ongoing dialogue between the regulator and the insurer and should be shared with those states an insurer is licensed in, as long as confidentiality, can be maintained. This letter or communication should be issued and delivered by the regulators to the board members and/or management based on the scope and severity of the issues identified.

In a recent session of the Chief Financial Regulator Forum, regulators discussed some practical matters related to the implementation of this guidance. Therefore, we’d like to ask that the Financial Examiners Handbook (E) Technical Group consider a few matters as follows:

1. There was consensus among chief regulators that Management Letters should be shared more proactively across states, as opposed to the current practice of providing the document upon request. Therefore, we’d encourage the Technical Group to consider whether the use of FEETs is an appropriate means of sharing Management Letters amongst state regulators. In consideration of this item, we’d also request consideration of the sensitivity of information on Management Letters and whether use of FEETS would compromise the intended confidentiality of the information contained therein.
   a. Assuming FEETs is chosen as a means of sharing the letters, the Technical Group may also want to consider whether additional language or warnings should be provided within the tool to remind the users of FEETS of the confidentiality of letters that are shared within FEETS.

2. A separate discussion was held on the matter of which individuals at a company the Management Letter should be shared with (i.e., board members and/or management). Although some basic guidance is already included in the Handbook on this topic, we ask that the Technical Group consider if clarifying language can be added on what types of issues should be shared with someone independent from company management and how.

In addressing these issues, it might be appropriate to consider whether additional Handbook guidance, sound practice considerations or educational/training materials should be developed to provide additional clarity in these areas.

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

Thank you for your consideration.
PHASE 7 – DRAFT EXAMINATION REPORT AND MANAGEMENT LETTER

This section of the Handbook addresses the following subjects:

A. Examination Report
B. Management Letter
C. Summary Review Memorandum
D. Letter of Representation

B. Management Letter

Significant results and observations noted during the examination that are not appropriate or necessary for inclusion in the public report, as determined by the state insurance department conducting the examination, should be communicated to the board and/or management. A management letter is considered an examination workpaper and may be used for this purpose. Those states not utilizing the management letter should communicate comments to the board and/or management during the exit conference or other means deemed appropriate. For group examinations, the lead state, after discussion with other participating states, will determine which results and observations will be included.

The letter to management, or other means of communication as determined by the state, can serve as a vehicle for an ongoing dialogue between the regulator and the insurer and should be shared with those states an insurer is licensed in, as long as confidentiality can be maintained. This letter or communication should be issued and delivered by the regulators to the board members and/or management based on the scope and severity of the issues identified.

Based on the findings to be included in the management letter, the examiner should determine the most appropriate party within the holding company structure to whom the letter should be provided. There may be circumstances when the examination team considers sharing the management letter to a level of the organization above the legal entity’s management and/or Board of Directors (i.e. parent company Board). Depending on the issues to be communicated, it may also be appropriate to prepare two different management letters; one to be delivered to management and/or BoD of the legal entity, and one to be delivered to a level of the organization above the legal entity.

When determining which findings are appropriate to communicate to a higher level within the organizational structure, the exam team should consider the significance and severity of the findings or comments, as well as the level at which corrective measures can be taken. For financial reporting matters, the exam team may utilize the definitions for material weakness or significant deficiency (refer to Phase 4 for definitions) to help with this assessment. Findings and comments meeting these definitions may be appropriate for communication to the board of directors and/or audit committee at a level above the legal entity. For other than financial reporting matters and issues or comments related to prospective risks, the examiner should consider the likelihood of such having a significant adverse impact on the insurer’s overall condition. Additional considerations include whether management at the legal entity level has a conflict of interest with the items to be communicated and/or whether management has sufficient understanding and capacity to anticipate and respond to changing conditions.

Examples of when it may be appropriate to provide the management letter at a level above the legal entity’s management and/or Board of Directors may include when a conflict of interest exists with the legal entity management/Board of Directors, and when a group management letter covering multiple companies is prepared.

The examiner should request a response from the company regarding the plan to address the identified issues. This response should be received within a reasonable time frame (e.g., 90 days) from the date the examiner issued the letter or communication. In addition to communication with the insurer, the examiner is responsible for communicating significant results and observations to the analyst and should consider including the analyst throughout the communication process with the insurer. In accordance with the Financial Analysis Handbook, the analyst must follow-up and document a review
of any management letter comments. The examiner should coordinate with the analyst on the follow-up of the identified issues. As the examiner moves on to other examinations, it is important that the analyst be involved with the resolution and monitoring of the identified issues.

**Example Management Letter**

An example management letter template has been developed below to provide a suggested format to examiners in drafting this correspondence. As with the elements that may be included within these non-public letters, the actual format utilized should be determined by the state insurance department conducting the examination.

June 1, 20XX
Board of Directors
XYZ Insurance Company (XYZ)

The Board of Directors (Board) has a duty to ensure that XYZ Insurance Company is operated in a safe and sound manner in the best interest of the policyholders. The Department of Insurance (the Department) is charged with the responsibility to protect insurance consumers and other creditors.

Following are comments related to the examination of XYZ Insurance Company as of December 31, 20XX, and other related information regarding XYZ. The Department has identified the following issues and concerns regarding specific operations or practices of the Company. In accordance with the nature of these items, the department has chosen not to include these comments within the Report of Examination.

For each item/issue noted:

- State the issue using a concise statement of the problem identified;
- Provide commentary on the examiner’s understanding on what caused or created this issue;
- Illustrate the effect of this issue including the materiality impact, and what impact it has had on the financial statements, the company’s financial condition, or company operations; and
- Provide information regarding the criteria that elevated this issue (i.e., non-compliance with statute).

We will review the response and determine what further actions are appropriate. Please contact me by telephone (*number*) or email (*xxxxxx@xxxxx*) if you have any questions.

Sincerely,
Examiner
October 21, 2019

Ms. Susan Bernard, Chair
Financial Examiners Handbook (E) Technical Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197
Attn: Ms. Bailey Henning, NAIC Examination Coordinator


Dear Ms. Bernard:

The undersigned interested parties appreciate the opportunity to provide comments in response to the Financial Examiners Handbook (E) Technical Group’s proposed revisions to the NAIC Financial Condition Examiners Handbook (“Handbook”) that were exposed during the recent conference call held on September 12, 2019. Included in the exposure draft is proposed changes to various sections of the Handbook, including issuance of the management letter.

Regarding management letters, there is proposed wording and examples of instances to determine the most appropriate party within the holding company structure to whom the management letter should be provided, e.g., the management or Board of Directors of (i) the subject insurance entity of the examination; (ii) the intermediate holding company or, possibly; (iii) the top-tier holding company. This determination may be difficult in instances where there are multiple levels of Boards of Directors or Audit Committees, which may be common for insurers with complex organizational structures (e.g., the ultimate parent may be a publicly traded holding company that operates different types of insurance such as healthcare, life, property and casualty, etc. through different ownership structures).

Interested parties offer the following comments related to that section of the exposure draft.

Management Letter and Appropriate Level of Communication

As provided in the Handbook, the purpose of the management letter is to communicate significant results and observations noted during the examination that are not appropriate or necessary for the inclusion in the public examination report.

Interested parties agree with the stated purpose of the management letter and note that while the intent is for significant results and observations to be communicated, there may be varying degrees of importance relating to any particular item within a management letter that the insurance department desires to communicate to the insurance company’s Board of Directors or Audit Committee.

As stated in the Handbook, it is critical that the management letter comments be communicated to the proper level of Board of Directors or designated Audit Committee. This decision should
be company and comment specific based upon the insurance company and holding company structure. It should also be based on clear guidance in the Handbook as to what constitutes “significant results” in the context of management letter comments.

**Organizational Structure**

In order to reflect the management of the individual insurance entities, the ultimate parent company is permitted to organize its corporate governance by electing to have the ultimate parent company’s Audit Committee designate, via written notice to its domiciliary commissioner, such oversight of one or more insurance entity subsidiaries by an Audit Committee at an intermediate holding company level or at the individual insurance entity level. This election is permitted within the *NAIC Annual Financial Reporting Model Regulation* (“NAIC MAR”), Section 14. The NAIC MAR should be considered in conjunction with Appendix G – Implementation Guide (Guide) for the Annual Financial Reporting Model Regulation (Model) of the *NAIC Accounting Practices and Procedures Manual* (“NAIC MAR Implementation Guide”). In any structure, however, the designated Board or Audit Committee must operate under the supervision of the ultimate holding company’s Board and/or Audit Committee.

While it is understood that the ultimate parent company has the responsibility for the overall governance of the insurance group, as noted in the exposure draft, certain items may not warrant the significance to be addressed by the ultimate holding company Board or Audit Committee if they do not rise to the level of “significant.” However, that term is then explained only by way of examples which interested parties do not believe are very common, nor sufficiently instructive. Interested parties believe that more appropriate guidance as to what constitutes “significant” in relation to management letter items can be found in the terms “significant deficiency” or “material weakness” as defined in the NAIC MAR and the NAIC MAR Implementation Guide.

**Definition of Significant Items and Observations**

As provided in the Handbook, significant results and observations noted during the examination that are not appropriate or necessary for the inclusion in the public report, as determined by the state insurance department conducting the examination, should be communicated to the board/audit committee and/or management. However, the term **significant results and observations** is inherently subjective and may lead to inconsistencies in items included in management letters if the term is not consistently defined and applied. This subjectivity may result in items not meeting the definition of a significant deficiency or a material weakness being communicated to the ultimate Board of Directors or Audit Committee.

Interested Parties believe the guidance included in Sections 11 and 14 of the NAIC MAR, and the corresponding NAIC MAR Implementation Guidance, as adopted by the respective state of domicile, is the intent of this reporting for financial issues. Accordingly, interested parties recommend that this definition be included within this section of the Handbook to promote consistency in what is determined a significant item for management letter reporting purposes.
Interested parties also understand that not all items that should be included in a management letter are financial in nature. Non-financial items that are qualitative or operational in nature and also meet the definition of a significant result or observation at the enterprise or group level could be included in the group management letter. Significant results and observations which meet the criteria of a significant deficiency or a material weakness as defined in the NAIC MAR Section 11 and the NAIC MAR Implementation Guide for financial issues and significant results and observations for non-financial issues that are qualitative and operational in nature at the enterprise level could be reported to the ultimate holding company Board or Audit Committee, while those issues that do not meet these definitions should be reported to the intermediate or entity Board, as applicable.

Other Comments and Observations

Interested parties agree that clarification is needed to properly identify the appropriate level of communication of matters noted in a management letter. It is also important to note that all comments should be thoroughly vetted with the insurer to ensure that the correct summary of the issue(s) is provided.

The examples provided in the exposure draft are not common, and therefore should be deleted. Interested parties believe it is beneficial to provide underlying guidance to clarify what should be reported to the ultimate parent Board rather than to an intermediate or individual entity Board or Audit Committee.

Proposed Modifications to the Exposure

Based upon the rationale provided, interested parties recommend changes (highlighted in yellow) to the exposure draft:

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B. Management Letter
Significant results and observations noted during the examination that are not appropriate or necessary for inclusion in the public report, as determined by the state insurance department conducting the examination, should be communicated to the board and/or management. A management letter is considered an examination workpaper and may be used for this purpose. Those states not utilizing the management letter should communicate comments to the board and/or management during the exit conference or other means deemed appropriate. For group examinations, the lead state, after discussion with other participating states, will determine which results and observations will be included.

The letter to management, or other means of communication as determined by the state, can serve as a vehicle for an ongoing dialogue between the regulator and the insurer and should be shared with those states an insurer is licensed in, as long as confidentiality can be maintained. This letter or communication should be issued and delivered by the regulators to the board members and/or management based on the scope and severity of the issues identified. Based on the findings to be included in the management letter, the examiner should determine the most appropriate party within the holding company structure to whom the letter should be provided. There may be circumstances where the examination team may consider sharing the management letter to a level of the organization above the legal entity’s management and/or Board of Directors or Audit Committee for those findings or comments that are “significant” as that term is used in the NAIC Annual Financial Reporting Model Regulation (MAR). In the MAR, a material weakness is defined as a deficiency, or combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the entity’s financial statements will not be prevented, or detected and corrected on a timely basis. A significant deficiency is a deficiency, or a combination of deficiencies, in internal control that is less severe than a material weakness, yet important enough to merit attention by those charged with governance. Both would be appropriate thresholds for examiners to apply in determining whether a management letter comment should be communicated to the ultimate Board of Directors or Audit Committee. Regarding management letter comments that relate to matters aside from internal controls over financial reporting, such as in respect of a particular prospective risk, similar thresholds should apply, e.g., that there is a reasonable possibility that a material risk will not be prevented, or sufficiently mitigated on a timely basis, or that otherwise is important enough to merit attention of the ultimate Board of Directors or Audit Committee. Other findings in management letters, including those that are more of a best practice recommendation, may be more appropriately communicated to the intermediate Board or the individual entity Board, where applicable.

The examiner should request a response from the company regarding the plan to address the identified issues. This response should be received within a reasonable time frame (e.g., 90 days) from the date the examiner issued the letter or communication. In addition to communication with the insurer, the examiner is responsible for communicating significant results and observations to the analyst and should consider including the analyst throughout the communication process with the insurer. In accordance with the Financial Analysis Handbook, the analyst must follow-up and document a review of any management letter comments. The examiner should coordinate with the analyst on the follow-up of the identified issues. As the examiner moves on to other examinations,
it is important that the analyst be involved with the resolution and monitoring of the identified issues.

**Example Management Letter:** [Note: the exposed text is not included as interested parties have no comments for this section]

* * *

Thank you for considering interested parties’ comments. If you have any questions in the interim, please do not hesitate to contact us.

<table>
<thead>
<tr>
<th>Organization</th>
<th>Name</th>
<th>Phone Number</th>
<th>E-mail Address</th>
</tr>
</thead>
<tbody>
<tr>
<td>American Council of Life Insurers</td>
<td>Mike Monahan</td>
<td>202-624-2324</td>
<td><a href="mailto:MikeMonahan@acli.com">MikeMonahan@acli.com</a></td>
</tr>
<tr>
<td>America's Health Insurance Plans</td>
<td>Tom Finnell</td>
<td>703-622-9155</td>
<td><a href="mailto:atfinnell@gmail.com">atfinnell@gmail.com</a></td>
</tr>
<tr>
<td>Blue Cross Blue Shield Association</td>
<td>Joe Zolecki</td>
<td>312-297-5766</td>
<td><a href="mailto:joseph.zolecki@bcbsa.com">joseph.zolecki@bcbsa.com</a></td>
</tr>
<tr>
<td>National Association of Mutual Insurance Companies</td>
<td>Jonathan Rodgers</td>
<td>317-876-4206</td>
<td><a href="mailto:jrogers@namic.org">jrogers@namic.org</a></td>
</tr>
<tr>
<td>American Property Casualty Insurance Association</td>
<td>Matthew Vece</td>
<td>(202) 828-7145</td>
<td><a href="mailto:matthew.vece@apci.org">matthew.vece@apci.org</a></td>
</tr>
<tr>
<td>Reinsurance Association of America</td>
<td>Joe Sieverling</td>
<td>202-783-8312</td>
<td><a href="mailto:sieverling@reinsurance.org">sieverling@reinsurance.org</a></td>
</tr>
</tbody>
</table>
EXHIBIT V – OVERARCHING PROSPECTIVE RISK ASSESSMENT

Background

The concept of risk on a risk-focused examination encompasses not only risks as of the examination date, but also risks that extend or commence during the time in which the examination was conducted, as well as risks that are anticipated to arise or extend past the point of examination completion. As such, consideration of prospective risks (including moderate or high residual risks existing at the balance sheet date that will impact future operations, risks anticipated to arise due to assessments of company management and/or operations, or risks associated with future business plans of the company) is an intrinsic element of a risk-focused examination and should occur throughout all phases of the examination process.

Use of this Exhibit

In completing this exhibit and documenting the examiner’s consideration of prospective risks throughout the examination process, the examiner should conduct an evaluation and, if possible, conduct examination procedures on the noted prospective insolvency risks to assess the degree of risk present and recommend future monitoring. Throughout the examination process and at the conclusion of the exam, the examiner should communicate with the department’s financial analysts to keep them informed of the identified prospective risks and examiner assessments. The branded risk classifications, risk assessment level and trend, and associated rationale should be used to summarize prospective risks identified for communication to the analyst via Exhibit AA—Summary Review Memorandum (SRM), and for internal use. This communication should include relevant details obtained during the examination that will enhance the ongoing monitoring of the company.

In conducting examinations of insurers that are part of a holding company group, it is important to note that many critical prospective risks may occur at the holding company level. The exam team should seek to coordinate the identification and assessment of prospective risk in accordance with the exam coordination framework and lead state approach outlined in Section 1 of this Handbook. Where possible, in a coordinated examination, the lead state’s work on prospective risk should be utilized to prevent duplication of effort and to leverage examination efficiencies.

As discussed throughout this Handbook guidance, the consideration of prospective risks should occur throughout each phase of the examination process. If the examiner identifies a prospective risk that relates to one specific key activity of the company, this prospective risk should be documented in the corresponding risk matrix for that key activity and treated similarly to other identified risks. However, if the examiner identifies an overarching prospective risk (a prospective risk that does not relate to a specific key activity—identified, or relates to more than one key activity—identified), the examiner should utilize this exhibit to document the process to consider these investigation of the overarching prospective risks. Individual risks should either be addressed on Exhibit V or a key activity matrix, but not both.

By the end of Phase 1, the examiner should have a preliminary listing of overarching prospective risks included on Exhibit V – Overarching Prospective Risk Assessment. By the end of Phase 2, the list of risks on Exhibit V should be updated to include all significant overarching prospective risks identified on Exhibit CC – Issue/Risk Tracking Template.

Prospective risks may continue to be identified beyond Phase 1 and Phase 2, but all significant overarching prospective risks identified during later phases of the exam should continue to be documented and investigated on Exhibit V, regardless of the phase in which the risk was identified.

All of the instructions for the investigation of prospective risks on Exhibit V should be completed by the end of Phase 5. It is not required that the various steps to investigate prospective risks on Exhibit V directly coincide with the seven-phase exam approach, but it is recommended that examiners complete each step of Exhibit V as early in the exam as practical to ensure each risk identified is sufficiently tested and reviewed.

Exhibit V, Part One – Overarching Prospective Risk Testing Template

Examiners should use this worksheet to document a review and testing of overarching prospective risks throughout the examination. Examiners may also use the examples provided on the template as a guide to assist in
determining the nature and extent of the prospective risk review to be performed. Please Note: The risk mitigation strategies identified in the template are only examples, and the examiner should be aware that the insurer might use other strategies to mitigate the identified risk. Instructions for completing and documenting a review of prospective risk within the template are as follows:

<table>
<thead>
<tr>
<th>Template Column</th>
<th>Instructions for Completing</th>
</tr>
</thead>
<tbody>
<tr>
<td>Overarching Prospective Risk Identified</td>
<td>Based on the knowledge and understanding of the company obtained during the planning stages of the exam, document any overarching prospective risks identified.</td>
</tr>
<tr>
<td>Branded Risk Classification</td>
<td>For each identified risk, document the associated branded risk classification(s) from the following list: Credit (CR), Legal (LG), Liquidity (LQ), Market (MK), Operational (OP), Pricing/Underwriting (PR/UW), Reputation (RP), Reserving (RV), and Strategic (ST).</td>
</tr>
<tr>
<td>Risk Mitigation Strategies</td>
<td>Identify risk mitigation strategies in place at the insurer (if any) to address the prospective risk.</td>
</tr>
<tr>
<td>Testing to support mitigation strategies Investigate Risk Exposure</td>
<td>Test the mitigation strategies identified by management. Consider both the design and operating effectiveness of the mitigation strategies as part of the procedures performed. Provide corroborating evidence and documentation to support the procedures performed. Perform additional independent testing, if necessary, to further understand or address the risk. Testing may include evaluation of the company’s historical trends, stress testing of company exposures, or other additional procedures specifically tailored by the examiner based on the company’s risk. Attach and reference supporting workpapers.</td>
</tr>
<tr>
<td>Corroborating Evidence and Documentation</td>
<td>Provide corroborating evidence and documentation supporting the risk mitigation strategy. Attach and reference supporting workpapers.</td>
</tr>
<tr>
<td>Prospective Risk Assessment</td>
<td>Using professional judgment, determine the appropriate prospective risk level (High, Moderate or Low) after considering the nature of the risk and the company’s mitigation strategies. Provide a brief explanation regarding the prospective risk level determined.</td>
</tr>
<tr>
<td>Risk Assessment Level</td>
<td>Document the risk assessment level of the identified risk considering the test procedures performed (i.e., Significant, Moderate, or Minimal). Refer to Exhibit AA—Summary Review Memorandum for guidance on determining an appropriate risk assessment level.</td>
</tr>
<tr>
<td>Trend</td>
<td>Document the trend level of the identified risk considering the test procedures performed to indicate the direction the risk is moving (i.e., Increasing, Static, or Decreasing). Refer to Exhibit AA—Summary Review Memorandum for guidance on determining an appropriate trend level.</td>
</tr>
<tr>
<td>Rationale</td>
<td>Document the rationale for the trend and level of concern.</td>
</tr>
<tr>
<td>Ongoing Examination Procedures and Follow-Up Communicate Findings to Financial Analysis</td>
<td>Document any additional procedures deemed necessary to be performed to further understand or address the risk. Document specific information to be communicated to the department analyst. Information should include specific procedures for continual monitoring, specific documents to obtain from the company, expected timelines for follow-up, and contact information. Describe the plan for follow-up, such as specific procedures for continual monitoring, communication with the analyst, limited scope examinations, revisions to the Supervisory Plan or Insurer Profile Summary, etc.</td>
</tr>
</tbody>
</table>

Exhibit V, Part Two – Common Areas of Concern

Examiners should use this as a reference guide to assist in identifying categories of prospective risk that may be relevant for review and inclusion on the Exhibit V, Part One. Note: examiners are not required to identify a risk from each category listed or provide a rationale for not identifying risks from the common areas of concern.
## Part One – Overarching Prospective Risk Testing Template

<table>
<thead>
<tr>
<th>Overarching Prospective Risk Identified</th>
<th>Branded Risk</th>
<th>Risk Mitigation Strategies</th>
<th>Investigate Risk Exposure</th>
<th>Risk Assessment Level</th>
<th>Trend</th>
<th>Rationale</th>
<th>Communicate Findings to Financial Analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td>Example Prospective Risk 1:</td>
<td>ST RP</td>
<td>The company has processes in place to monitor and manage its financial performance in accordance with metrics considered significant by rating agencies. The company utilizes modeling to determine its economic and rating agency capital needs.</td>
<td>Reviewed financial reports for evidence of monitoring of rating agency performance measures and management review, noting that the company appears to be meeting its benchmarks (See wp A.1.4). Obtained and reviewed the economic capital calculation at 12/31/XX, noting that rating agency considerations are included in the process and that the company appears to hold capital in excess of the calculated amount. See A.1.5 for more information.</td>
<td>Moderate</td>
<td>Static</td>
<td>The company has product lines sensitive to a ratings decrease; however, it appears the company has appropriate controls and strategies in place to maintain strong ratings.</td>
<td>If a future rating downgrade occurs the DOI should meet to determine an appropriate course of action (e.g., limited scope exam).</td>
</tr>
</tbody>
</table>

| Example Prospective Risk 2:            | LG ST        | Mergers and acquisitions are part of the company’s growth strategy and incorporated into its 3-year strategic plan. The company has a defined due diligence process which includes detailed procedures for mergers & acquisitions, and business | Obtained the most recent strategic plan and verified that it discussed the company’s plan for future mergers and acquisitions to support its strategic goals. | Significant | Increasing | Although the company is actively involved with merger and acquisition activities, the exam team verified that | The exam team is comfortable with the Company’s abilities with regard to mergers and acquisitions. However, if the |

Commented [HB1]: Due to the extent of changes to format and content of the examples, tracked changes are not shown.
<table>
<thead>
<tr>
<th>Overarching Prospective Risk Identified</th>
<th>Branded Risk</th>
<th>Risk Mitigation Strategies</th>
<th>Investigate Risk Exposure</th>
<th>Risk Assessment Level</th>
<th>Trend</th>
<th>Rationale</th>
<th>Communicate Findings to Financial Analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td>successfully executed, resulting in excessive cost and/or regulatory concerns.</td>
<td>divestitures. The process is reviewed annually, making changes as needed, and approved by the Board of Directors and senior management. The company has a mergers and acquisitions steering committee that meets quarterly to review analyses and forecasts prepared for planned and/or in-process mergers/acquisitions/divestitures.</td>
<td>Reviewed minutes from the 20XX annual Board of Directors meeting, noting that the mergers &amp; acquisitions process was reviewed and approved by the Board of Directors and Management. (See wp B.2.2) The exam team also obtained documentation from the company’s most recent acquisition of XLX Corporation and confirmed that the due diligence process outlined in the M&amp;A policy was followed. (see additional detail regarding documents reviewed at B.2.PRG)</td>
<td>Reviewed minutes from Q1 and Q3 M&amp;A steering committee meetings and verified that financial details regarding the anticipated acquisition of FLH insurance company were discussed. (see wps B.2.3 and B.2.4)</td>
<td>Minimal</td>
<td>Static</td>
<td>The company</td>
<td>The analyst identified changes to the Company’s strategic business plan, the DOI should meet to discuss whether the changes warrant action before the next examination date.</td>
</tr>
<tr>
<td>Overarching Prospective Risk Identified</td>
<td>Branded Risk</td>
<td>Risk Mitigation Strategies</td>
<td>Investigate Risk Exposure</td>
<td>Risk Assessment Level</td>
<td>Trend</td>
<td>Rationale</td>
<td>Communicate Findings to Financial Analysis</td>
</tr>
<tr>
<td>----------------------------------------</td>
<td>-------------</td>
<td>----------------------------</td>
<td>---------------------------</td>
<td>----------------------</td>
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<td>---------------------------------------------</td>
</tr>
<tr>
<td>Prospective Risk 3: The company is developing new products and may experience issues in pricing, underwriting, and reserving.</td>
<td>significant research regarding current market conditions and demands, product mix and profitability, and other product/market characteristics on a regular basis. Reports summarizing the findings are generated monthly. The company has a group of individuals from departments across the company (legal, actuarial, marketing, financial, etc.) that compose an ad-hoc group specifically charged with product development. This group has significant experience in developing, marketing and pricing new products. Issuance of new products requires input and approval from the board of directors. There is a special subcommittee that meets on a quarterly basis to discuss company strategy and new product development.</td>
<td>market conditions report, noting that the company has compiled detailed industry information regarding similar products and pricing, market demand, customer location, etc. (see A.2.1). Reviewed the qualifications and background of the employees within the product development “team,” noting that all members have extensive experience in the many aspects of product development. Further, noted that this group maintains an action plan, approved by the board of directors, which details key procedures and areas of research necessary for product development, as well as a description of the various levels of review that occur throughout the product development process (see A.2.3).</td>
<td>has a verified history of successful product launches and its process for considering and launching products going forward is fully vetted throughout the company. Obtained meeting has a verified history of successful product launches and its process for considering and launching products going forward is fully vetted throughout the company.</td>
<td>be asked to monitor financial ratios related to new lines of business and report any significant deviations to the exam unit.</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

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<table>
<thead>
<tr>
<th>Overarching Prospective Risk Identified</th>
<th>Branded Risk</th>
<th>Risk Mitigation Strategies</th>
<th>Investigate Risk Exposure</th>
<th>Risk Assessment Level</th>
<th>Trend</th>
<th>Rationale</th>
<th>Communicate Findings to Financial Analysis</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td></td>
<td>minutes from the committee of the board of directors demonstrating discussion of potential new products, considerations for pricing, and board approval for the issuance of the new product (see A.2.4). Board meeting materials were also reviewed (A.2.5).</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
PART TWO – COMMON AREAS OF CONCERN

The prospective risk categories provided within this exhibit are not designed to be an all-inclusive list and might not apply to all insurance companies under examination. The examiner’s understanding of the company obtained in Phase 1, including a review of the company’s Enterprise Risk Report (Form F) and/or ORSA Filing, should be utilized to determine whether risks in these categories might be applicable to the company. The company will likely face additional prospective risks that do not fit within the categories in this exhibit.

<table>
<thead>
<tr>
<th>Prospective Risk Category</th>
<th>Comments</th>
</tr>
</thead>
<tbody>
<tr>
<td>Merger and Acquisition Activity</td>
<td>If applicable, review the company’s process to identify and perform due diligence on potential acquisitions. In addition, consider reviewing the company’s process to integrate acquired entities and business into its systems.</td>
</tr>
<tr>
<td>Product Development</td>
<td>If applicable, review and assess the company’s process to identify, develop, price and market new products in accordance with the company’s strategy and business needs.</td>
</tr>
<tr>
<td>Legal and Regulatory Changes</td>
<td>If applicable, review how the company identifies, monitors and addresses changes to the legal and regulatory environment it operates within. For example, review the company’s processes in place to analyze the impact that health care reform could have on the company, including support for company projections and strategies for appropriateness.</td>
</tr>
<tr>
<td>HR/Personnel Risks</td>
<td>If applicable, review and assess the company’s HR processes to identify, mitigate and monitor risks related personnel management (including succession planning for critical positions) as well as hiring, managing, retaining and terminating personnel in accordance with company needs.</td>
</tr>
<tr>
<td>Strategic Planning</td>
<td>If applicable, review and assess the company’s processes for strategic planning to determine whether the company regularly analyzes its strengths and weaknesses, as well as opportunities and threats, on an ongoing basis. In addition, it might be appropriate to review the company’s process to update its overall business plan on a regular basis.</td>
</tr>
<tr>
<td>Compensation Structure</td>
<td>If applicable, review the company’s process for developing, monitoring and adjusting its compensation structure to ensure that employees are appropriately compensated without creating an incentive to misrepresent financial results.</td>
</tr>
<tr>
<td>Rating Agency Downgrade</td>
<td>If applicable, review the company’s process to monitor and prepare for potential adverse changes in its credit ratings. If a future rating agency downgrade is deemed likely, consider whether the company is adequately prepared to handle the results of such a downgrade.</td>
</tr>
<tr>
<td>Costs of Capital</td>
<td>If applicable, review the company’s access and ability to obtain capital, reinsurance and letters of credit, if necessary, to meet funding and risk diversification needs.</td>
</tr>
<tr>
<td>Business Continuity</td>
<td>If applicable, review the company's business continuity plan. Follow the steps outlined in Section 1, Part III.</td>
</tr>
<tr>
<td>Climate Change</td>
<td>If applicable, review the company’s process for identifying and monitoring risks resulting directly or indirectly from the impact of climate change risk.</td>
</tr>
</tbody>
</table>
EXHIBIT AA
SUMMARY REVIEW MEMORANDUM

The following is an illustration of how a summary review memorandum (SRM) may be set up to assist examiners in documenting the key issues and results of a risk-focused examination that should be shared with the Chief Examiner and the assigned analyst. The illustration also includes a high-level overview of the insurer’s holding company structure (if applicable) and how that structure affected exam coordination with other states. Additionally, the SRM includes discussion of the insurer’s governance and risk management practices, and a summary, by branded risk classification, of significant exam findings and/or concerns warranting communication. These findings may include overarching solvency concerns, examination adjustments, other examination findings, management letter comments, subsequent events and other residual risks or concerns the examiner may want to communicate to department personnel. The final sections, prioritization level and changes to the supervisory plan, provide discussion of the examiner’s overall conclusions regarding ongoing monitoring, including specific follow-up recommended to the analyst.

This exhibit provides an example template, which is not intended to be all-inclusive and should be tailored to each examination. Reference to each branded risk classification is necessary and should be included in the examination’s SRM; however, it is not necessary to address each of the supporting areas and points discussed herein. Therefore, the examiner-in-charge should use his or her judgment in determining which sections of this illustration are applicable and document any other relevant information deemed necessary. The purpose of the SRM is to provide interpretative analyses relative to significant examination areas and to provide a basis for communicating examination findings and recommendations to department personnel. In so doing, the SRM will provide input into the Insurer Profile Summary (IPS) and the supervisory plan. In fulfilling this purpose, the SRM should not merely repeat comments made in the examination report or management letter, but instead provide a comprehensive summary of examination conclusions both objective and subjective in nature. Conclusions should provide information necessary for ongoing supervision of the insurer that includes areas of concern as well as areas that support a positive outlook for the insurer.

COMPANY NAME: EXAMINATION DATE:

EXAMINATION BACKGROUND

The purpose of this section of the memorandum is to document at a high level what, if any, group the insurer belongs to, if the insurer was part of a coordinated exam and how the coordinated exam was conducted. Additional information regarding the timing of the exam, staffing resources utilized—including what specialists were used—or other background information necessary to understand the results presented in the memo should also be included.

GOVERNANCE AND RISK MANAGEMENT

The purpose of this section of the memorandum is to summarize an understanding and assessment of an insurer’s board of directors, senior management and organizational structure, as well as the results of the review of the enterprise risk management (ERM) function of the insurer. This assessment should include information obtained during both the planning and the completion stages of the examination. Therefore, consideration of information gathered during C-level interviews, completion of Exhibit M and review of the insurer’s Own Risk and Solvency Assessment (ORSA), if applicable, should be combined with information obtained during detail testwork to reach a concise final assessment that focuses on communicating significant areas of strength or weakness within the overall corporate governance and ERM functions of the insurer. When the insurer is part of a holding company, documentation should reference the level at which conclusions are reached. Additional assessment may be necessary at the individual entity level, but the primary focus of the assessment will commonly be at the holding company level in a coordinated examination.

BRANDED RISK ASSESSMENTS

This section of the memorandum should be organized to address each of the nine branded risk classifications: Credit; Legal; Liquidity; Market; Operational; Pricing/Underwriting; Reputation; Reserving; and Strategic. If needed, an Other category may also be used. In documenting each assessment, consideration should first be given to the branded risk...
assessments provided by the analyst in the initial IPS. The examiner then summarizes the work performed during the examination to arrive at a final assessment for each classification. For those branded risk classifications that are not impacted by examination results and provide no additional information for the ongoing monitoring of the insurer, this can be noted without further explanation. For those classifications that are impacted, documentation in the summary should focus on new information uncovered during the course of the examination and should not duplicate the summary initially provided in the IPS. The summary for each classification should be prepared at a level of detail that will enable the analyst to update the existing IPS and understand the context for items that require additional follow-up or specific monitoring procedures. This may be done within the table format provided below, referencing other examination documents as necessary.

In documenting the key points for each branded risk classification, consideration should be given to the following areas, if deemed applicable:

- Prospective solvency concerns
- Examination adjustments
- Control/risk mitigation strategy issues
- Report findings and management letter comments
- Responses to issues raised by financial analysis
- Subsequent events
- Residual risks and concerns

Following the summary, the examiner should update the areas of concern, as needed, based on the information obtained during the examination and provide an overall assessment of minimal, moderate or significant concern for each branded risk classification. The SRM is a primary tool for communicating the results of an examination to the financial analysis function. Therefore, it is important that the examiners have the same understanding of the considerations going into the risk assessment level and trend. The following guidelines may be used to assist in assigning the risk assessment level and trend, when necessary. Additional guidance for selecting the risk assessment level and trend is available in the Financial Analysis Handbook.

**Risk Assessment Level Considerations:**

- **Significant:** The highest level of severity of risk from a solvency perspective. Risks assessed at this level require an elevated level of ongoing monitoring and/or regulatory action.
- **Moderate:** The medium level of severity of risk from a solvency perspective. Risks assessed at this level require routine ongoing regulatory monitoring and oversight and/or regulatory action.
- **Minimal:** The lowest level of severity of risk from a solvency perspective. Risks assessed at this level do not currently indicate a need for additional monitoring or regulatory actions.

**Risk Assessment Trend Considerations:**

- Consider trending within quantitative metrics to assist in determining the trend assessment
- Consider qualitative factors such as the insurer’s planned business strategies to address the risk
- Consider both historical/current and prospective/planned trends in exposure

If the examiner’s assessment is different from the original assessment documented in the IPS, the information summarized must provide sufficient detail to support the change. Issues that require specific monitoring or follow-up by the analyst should then be identified individually in the table under the section designated for recommended follow-up. This table includes a brief reference to the issue, recommended follow-up or action items to be performed and the timeline in which the analyst should expect to obtain information referenced in the follow-up procedures.
Branded Risk Classification (Example: Credit)

Note: A separate summary and table should be completed for each of the nine branded risk classifications, as well as a category for Other, if deemed necessary.

**Analyst Initial Assessment**

**Credit:** This risk is considered moderate, driven primarily by a fairly conservative investment mix (96.4% of bonds are NAIC 1 designation, with 28% U.S. government, 14% U.S. states and most of the rest high-quality corporates) and limited exposure to equities, offset by a relatively high amount of real estate ($33 million), growing agent balances ($99 million) and significant reinsurance recoverables (paid and unpaid) of $81 million. However, the reinsurance recoverables are diversified across a number of highly rated reinsurers.

<table>
<thead>
<tr>
<th>No/Minimal Concern</th>
<th>Moderate Concern</th>
<th>Significant Concern</th>
<th>Trend</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonds</td>
<td></td>
<td></td>
<td>↔</td>
</tr>
<tr>
<td>Reinsurance Recoverables</td>
<td></td>
<td></td>
<td>↑</td>
</tr>
<tr>
<td>Real Estate – Home Office</td>
<td></td>
<td></td>
<td>↔</td>
</tr>
<tr>
<td>Agent Balances and Uncollected Premiums</td>
<td></td>
<td></td>
<td>↑</td>
</tr>
</tbody>
</table>

**Examiner Summary and Assessment**

**Credit:** Examiner agrees with analyst assessment regarding bonds and reinsurance recoverables. Although the reinsurance recoverables balance has increased significantly in recent years, the change is in line with increases in premium volume and strategic plan of partnering with high-quality reinsurers to increase the volume of its product liability business. Real Estate – Home Office was tested during the exam, with a recent appraisal reviewed showing the value of the property to be $40 million. Therefore, the examiner proposes that the credit risk associated with the home office be reclassified as a minimal concern. In reviewing agent balances, the exam team recognized a growing concern regarding slow-paying agents for the company’s growing product liability business. In discussing this with the company, a lack of company controls related to agency audits was noted. As such, the exam team agrees with the analyst’s assessment of high credit risk in this area and has included a management letter comment regarding agency audits as described below.

<table>
<thead>
<tr>
<th>No/Minimal Concern</th>
<th>Moderate Concern</th>
<th>Significant Concern</th>
<th>Trend</th>
</tr>
</thead>
<tbody>
<tr>
<td>Bonds</td>
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<tr>
<td>Reinsurance Recoverables</td>
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<tr>
<td>Real Estate – Home Office</td>
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<tr>
<td>Agent Balances and Uncollected Premiums</td>
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</tbody>
</table>

**Recommended Follow-Up**

<table>
<thead>
<tr>
<th>Issue</th>
<th>Recommended Follow-Up</th>
<th>Timeline</th>
</tr>
</thead>
<tbody>
<tr>
<td>See ML #2 – Lack of a consistent agency audit process</td>
<td>Company was asked to establish a consistent agency audit plan to ensure accurate and complete premium and claim reporting. Analyst is asked to follow-up on company activity in this area by requesting a copy of the audit plan and selecting a sample of agency audit reports to request and review.</td>
<td></td>
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</tbody>
</table>

**ISSUES OF NON-COMPLIANCE**

The purpose of this section is to describe any issues of non-compliance identified during the examination. These issues typically do not have a significant impact on the assessment of each branded risk classification, but are important to communicate and ensure proper follow-up is performed.
<table>
<thead>
<tr>
<th>Issue</th>
<th>Recommended Follow-Up</th>
<th>Timeline</th>
</tr>
</thead>
<tbody>
<tr>
<td>See ML #1 – Schedule F reporting</td>
<td>Company was asked to report reinsurance data on Schedule F on a gross basis in all instances. Analyst asked to follow-up by closely monitoring Schedule F and reinsurance Jumpstart reports.</td>
<td>Follow-up recommended in conjunction with quarterly and annual financial statement analysis through 20XX.</td>
</tr>
</tbody>
</table>

**PRIORITIZATION AND ONGOING MONITORING**

The purpose of this section of the memorandum is to allow the examiner to document any suggested changes to the prioritization level and/or to document the examiner’s rationale for maintaining the current prioritization level.

**PROPOSED CHANGES TO SUPERVISORY PLAN**

The purpose of this section of the memorandum is to propose any changes to the supervisory plan that the examiner believes are necessary based on the preceding information.
<table>
<thead>
<tr>
<th>Topic</th>
<th>Referral (If Applicable)</th>
<th>Request/Issue to be addressed</th>
<th>Progress</th>
</tr>
</thead>
<tbody>
<tr>
<td>1 Consistency and Uniformity Among States in Assessing Corporate Governance</td>
<td>Corporate Governance (E) Working Group April 7, 2013 Financial Condition (E) Committee - April 5, 2016</td>
<td>Develop a regulator tool to encourage uniformity and consistency in reviewing corporate governance practices across regulatory functions. This is a long-term project that will be considered at a later date, once more states have adopted the CGAD</td>
<td>N/A at this time.</td>
</tr>
<tr>
<td>2 Enhanced Regulatory Guidance</td>
<td>Financial Analysis (E) Working Group May 14, 2018</td>
<td>Consider whether guidance should be revised to address issues related to insurance policies with large deductibles, merger and acquisition activity, and use of captives.</td>
<td>Minor revisions to underwriting repository in 2018 to add consideration of insurers with large deductible policies. Merger &amp; acquisition activity is referenced in multiple places throughout the Handbook as a potential area of concern. Use of captives to be considered as part of Reserves Repository maintenance</td>
</tr>
<tr>
<td>3 Examination Process Enhancements</td>
<td>Risk-Focused Surveillance (E) Working Group May 14, 2018</td>
<td>Based on feedback from the Exam Peer Review project, the Handbook Technical Group has been asked to consider the following: - Add an interview template for the Chief Marketing Officer - The order in which interviews should be conducted - Revisions to the format of Exhibit V to assist examiners in properly addressing prospective risks during the course of an exam.</td>
<td>Revisions related to interviews adopted on September 12, 2019 conference call. Revisions related to Exhibit V enhancements to be considered for adoption on November 14, 2019 conference call.</td>
</tr>
<tr>
<td>4 Management Letter Considerations</td>
<td>Chief Financial Regulator Forum October 26, 2018</td>
<td>Considerations related to the Management Letter, including whether the FEETS application might be used as a means for sharing this document among regulators and which individuals within a company should receive a copy of the letter.</td>
<td>Guidance revisions related to management letters to be considered for adoption on November 14, 2019 conference call. Enhancements to FEETS to be implemented in early 2020.</td>
</tr>
<tr>
<td></td>
<td>Topic</td>
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<tr>
<td>6</td>
<td>Troubled Insurance Companies</td>
<td>Financial Analysis Solvency Tools (E) Working Group February 27, 2019</td>
<td>Due to recent revisions to the NAIC’s <em>Troubled Insurance Company Handbook</em> (TCH), the FEHTG and FASTWG have been asked to consider whether existing guidance adequately addresses specific elements highlighted in the TCH. These elements include guidance for priority ratings, communication and pre-receivership considerations.</td>
</tr>
<tr>
<td>7</td>
<td>Credit for Reinsurers</td>
<td>Added Nov 2019</td>
<td>NAIC staff to consider possible revisions to reinsurance guidance in light of changes to Credit for Reinsurance Model Law (#785) and Regulation (#786)</td>
</tr>
<tr>
<td></td>
<td><strong>Annual Maintenance</strong></td>
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<tr>
<td>1</td>
<td>Repository Maintenance</td>
<td>Annual repository review to ensure repositories contain appropriate and relevant risks and related test procedures.</td>
<td>Volunteer drafting group of the Technical Group has received input from Life Actuarial (A) Task Force, Health Actuarial (B) Task Force and Actuarial Opinion (C) Working Group regarding possible changes to reserves repositories.</td>
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<tr>
<td></td>
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<td>2019: Reserves</td>
<td>This project is expected to carry over into 2020.</td>
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<tr>
<td>2</td>
<td>Handbook Cleanup</td>
<td>On an annual basis, consider revisions to the Handbook to ensure consistency of guidance. Allow for feedback through the use of a “Proposal Submission Form”.</td>
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