Draft date: 10/27/2025

Virtual Meeting

FINANCIAL EXAMINERS HANDBOOK (E) TECHNICAL GROUP
Thursday, November 20, 2025
12:00 – 1:00 p.m. ET / 11:00 a.m. – 12:00 p.m. CT / 10:00 – 11:00 a.m. MT / 9:00 – 10:00 a.m. PT

ROLL CALL

Eli Snowbarger, Co-Chair	Oklahoma	Shannon Schmoeger/Sara McNeely	Missouri
John Litweiler, Co-Chair	Wisconsin	Andrea Johnson	Nebraska
Blasé Abreo	Alabama	Colin Wilkins	New Hampshire
Laura Clements	California	Nancy Lee Chice	New Jersey
William Arfanis	Connecticut	Monique D. Smith	North Carolina
N. Kevin Brown	District of Columbia	Tracy Snow/Zachary Wheatley	Ohio
Cindy Andersen	Illinois	Diana Sherman	Pennsylvania
Grace Kelly	Minnesota	Tarik Subbagh	Washington

NAIC Support Staff: Elise Klebba/Bailey Henning

AGENDA

1. Consider Adoption of Handbook Guidance — *John Litweiler (WI)*
   a. Revisions Regarding Use of AI In Exams — Attachment 1
      - AHIP Comment Letter — Attachment 1-A
      - NAMIC Comment Letter — Attachment 1-B
      - APCIA Comment Letter — Attachment 1-C
   b. Revisions Pertaining to Recent SAPWG Adoptions — Attachment 2
   c. Revisions Pertaining to AG 55 — Attachment 3
   d. Risk Matrix Verbiage — Attachment 4

2. Discuss Any Other Matters Brought Before the Technical Group – *Eli Snowbarger (OK)*

3. Adjournment

INTRODUCTION

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G. Confidentiality

The NAIC Model Law on Examinations (or a substantially similar provision) is required to be part of state law in accordance with accreditation guidelines. This Model Law provides specific guidelines regarding the confidentiality of information developed, received, or disclosed through the course of conducting financial and market conduct examinations, including the course of analysis. As detailed within this Model Law, documents, materials, or other information, including but not limited to all working papers, and copies thereof, created, produced or obtained by or disclosed to the commissioner or any other person in the course of an examination, or in the course of analysis by the commissioner of the financial condition or market conduct of a company shall be confidential by law and privileged and shall not be subject to public disclosure, shall not be subject to subpoena, and shall not be subject to discovery or admissible in evidence in any private civil action.

In accordance with the revised risk-focused surveillance approach contained within this Handbook, it is anticipated that the financial examiners will be incorporating new tools to document their examination approach and results (e.g., Insurer Profile Summary, Risk Assessment Matrix, Supervisory Plan and Summary Review Memorandum). Similar to other documentation completed in accordance with a financial condition examination, these tools shall be considered confidential under state law including the state's examination law. Although the risk-focused examination approach envisions enhanced communication between state insurance department examiners and analysts, the sharing (and potential further development) of these examination workpapers to and by financial analysis regulators, or to other individuals within a state insurance department, shall not impact their confidential status. All examination workpapers, including those mentioned above may be shared with other regulators whose state insurance departments have the authority under state law to preserve the confidentiality of the information they receive. (The confidentiality provisions related to examination workpapers apply to both examinations of insurance companies and holding companies.)

State insurance departments that utilize contract examiners should continue to remind such examiners of the responsibility to keep insurer-specific information confidential. Furthermore, the communication of effective practices employed by one insurer (whether it is a practice pertaining to the development or marketing of specific products, established controls, documentation of activities, etc.) to other entities may be perceived as a violation of trade secrets and should be restricted by both state and contract examiners.

If state insurance departments utilize artificial intelligence (AI) tools within examinations, these should be used in a manner consistent with applicable confidentiality requirements. Examiners should not input any confidential, non-public, personally identifiable, or proprietary information obtained during the examination process into external, public-facing, AI platforms. Such information includes, but is not limited to:

- Insurer-specific financial or operational information
- Examination workpapers
- Internal insurer communications or documents
- Any information protected under law, regulation, or the NAIC Model Law on Examinations (#390).

To safeguard confidential information, examiners should limit their use of tools to those expressly approved by the state insurance department and hosted in secure, department-managed environments. If a secure AI tool is not available, examiners must ensure any data is fully anonymized to remove any non-public or sensitive information. For more information on considerations when utilizing AI in examinations, please refer to Section 1-4 in this Handbook.

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IV. STANDARD EXAMINATION PROCEDURES

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F. Examination Review Responsibilities

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d. Detailed Review

All workpapers require a detailed review. On larger examinations, there may be two or more detailed reviewers, each with responsibilities for particular areas. On smaller examinations, typically there will be only one detailed reviewer.

The completion of the risk assessment enables examiners to plan the review to be proportionate to the risk of material error in specific accounts and transactions. This risk of material error and the technical competence and experience of the assigned staff personnel will influence who should perform the procedures in each area. These same factors should influence the selection of the detailed reviewer for each area.

For example, an examiner-in-charge ordinarily will perform procedures in areas requiring significant subjective judgments. As a result, the chief examiner, or designee, would perform a detailed review of the work in these areas.

The emphasis of a detailed review is on the technical accuracy and completeness of the workpapers. A detailed reviewer should determine whether:

- Procedures in the examination program were properly performed. These procedures should be cross-referenced from the examination program to the workpapers where the work is evidenced.
- Conclusions are clearly documented and adequately supported by the workpapers. A detailed reviewer should determine whether all tick marks are clearly explained, all significant or unusual amounts are appropriately supported and explained, and any ambiguous comments are clarified or removed.
- Procedures performed were sufficient in light of the examination findings and any changes in conditions occurring since the procedures were planned. The examination program is developed from expectations based on conditions existing during the planning process. Therefore, examiners should evaluate the results of procedures against those expectations, considering any subsequent changes in conditions.

Detailed review of the workpapers is especially critical if the examiner is utilizing AI during the examination. The guidance below applies when the use of AI contributes to the development of examination evidence and does not apply to basic rewording, proofreading, and editing. Content generated by AI may contain factual inaccuracies, reflect unintended bias, or present information in a manner that appears authoritative but lacks supporting evidence. As such, examiners should not rely upon content generated by AI tools without reviewing and validating the accuracy, appropriateness and relevance of the output with professional skepticism.

If AI generated outputs are incorporated into examination work, the examiner should also document the nature of the AI usage. Documentation should indicate which tool was used and that the examiner reviewed and validated the content prior to its inclusion. For further information on confidentiality considerations when using AI in examinations, please refer to the Introduction section of this Handbook.

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November 13, 2025
Eli Snowbarger, Co-Chair
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Financial Examiners Handbook (E) Technical Group
National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197

By Email to: Elise Klebba at eklebba@NAIC.org.

Re: NAIC Financial Examiners Handbook (E) Technical Group

Dear Mr. Snowbarger and Mr. Litweiler,

On behalf of AHIP, thank you for the opportunity to submit comments on the exposed proposed changes to the Financial Examiners Handbook.

AHIP's comments are limited to the sections of the exposure relating to the use of artificial intelligence (AI) by regulators on examinations. Our comments are summarized as follows:

1. To consider whether the proposed guidance for examines is sufficient, it would be helpful for Interested Parties to better understand from the working group the current and anticipated usage of AI by examiners on insurer examinations.
2. Examination processes should ensure that examiners provide the insurer under examination transparency into their use of AI and opportunities for input. Further there should be transparency by the insurer into any key conclusions reached using AI systems.
3. Any AI-related guidance for department examiners should extend to contract examiners as well. There may be need for additional guidance for contract examiners given the diversity of individuals and firms involved and their relative degree of experience involving AI and controls over the use of AI.
4. Comparable guidance should be developed for use of AI by market conduct examiners, if not in development already.

A joint regulator-industry process should be established to finalize the initial effort to develop AI-guidance for examiners (perhaps referring any guidance to the (H) Committee) and to monitor ongoing development, benefits, risks, and other consequences of examiners' continued use of AI on examinations.

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Thank you for the chance to comment. We look forward to further discussions with the Technical Group.

Sincerely,
Miranda Motter
AHIP Senior Vice President, State Affairs and Policy
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202-923-7346

CC: LaCosta Wix, Senior Regulatory Counsel
Tom Finnell, AHIP Consultant

AHIP is the national association whose members provide health care coverage, services, and solutions to hundreds of millions of Americans every day. We are committed to market-based solutions and public-private partnerships that make health care better and coverage more affordable and accessible for everyone. Visit www.ahip.org to learn how working together, we are Guiding Greater Health.

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November 13, 2025

VIA ELECTRONIC SUBMISSION

Mr. Eli Snowbarger, Chair
Financial Examiners Handbook (E) Technical Group
National Association of Insurance Commissioners
c/o Elise Klebba
Via Email: eklebba@naic.org

RE: Revision of Financial Examiners Handbook Incorporating Guidance Related to the Use of Artificial Intelligence (AI) in Exams

Dear Mr. Snowbarger,

Thank you for the opportunity to comment on the revision of the Financial Examiners Handbook (the Handbook) on guidance related to use of artificial intelligence (AI). The following is submitted on behalf of the member companies of the National Association of Mutual Insurance Companies (NAMIC).[1] NAMIC is appreciative of your work on this topic and looks forward to working together.

First, we think the placement of this new guidance under "G. Confidentiality" is the appropriate spot. The confidentiality of any insurer information is highly important to the financial exam process. Given the importance of confidentiality, we suggest that the guidance make explicitly clear that the expectations in this section extend to any contract examiners or vendors that a department may use in the course of an examination. We suggest this could be addressed through addition of a sentence stating: "The expectations contained in this section apply equally to state insurance department examiners as well as any contract examiners or vendors a department may use in the course of an examination."

We also appreciate the statement that examiners should not input any confidential information, non-public, personally identifiable, or proprietary information obtained during the examination process into external, public-facing, AI platforms. From our perspective, that description suggests it is only appropriate to use internally hosted or internally integrated models for inputting

[1] NAMIC has more than 1,500-member companies representing 40 percent of the total U.S. property/casualty insurance market. NAMIC member companies serve more than 170 million policyholders and write more than $323 billion in annual premiums. Our members' direct written premiums account for 67 percent of homeowners' insurance and 55 percent of automobile insurance. Through NAMIC advocacy programs it promotes public policy solutions that benefit NAMIC member companies and the policyholders they serve and fosters greater understanding and recognition of the unique alignment of interests between management and policyholders of mutual companies.

information obtained during the examination process. We suggest the following edit, striking the current language and inserting the language in red:

> ~~Examiners should not input any confidential, nonpublic, personally identifiable, or proprietary information obtained during the examination process into external, public-facing, AI platforms.~~
> Given the nature of examination information being confidential, nonpublic, personally identifiable, or proprietary, examiners or contract examiners shall not use external, public-facing AI platforms. Examiners should only input examination information into internally hosted or internally integrated models or custom AI applications.

While we appreciate the guidance emphasizing detailed review of workpapers if the examiner is utilizing AI during the examination, we find that the explanation of perceived AI risks is too broad and conclusive as applied to all types of available AI models, and therefore suggest the following edit in red:

> Detailed review of the workpapers is especially critical if the examiner is utilizing AI during the examination. The guidance below applies when the use of AI contributes to the development of examination evidence and does not apply to basic rewording, proofreading, and editing. ~~Content generated by AI may contain factual inaccuracies, reflect unintended bias, or present information in a manner that appears authoritative but lacks supporting evidence. As such, examiners should not rely upon content generated by AI tools without reviewing and validating the accuracy, appropriateness and relevance of the output with professional skepticism.~~ Examiners should review and validate the accuracy, appropriateness, and relevance of any AI output used in the exam process.

Lastly, we appreciate and support the language stating that examiners should document use of AI. In this vein, we further suggest that the guidance should include discussion between examiners and insurers about the reviewers' intended use of AI during the exam, as well as including AI use as part of the status update meetings throughout the exams and in the exit meeting. We suggest incorporating the language in red:

> If AI generated outputs are incorporated into examination work, the examiner should also document the nature of the AI usage. Documentation should indicate which tool was used and that the examiner reviewed and validated the content prior to its inclusion. In addition to the documentation, examiners should ensure they are discussing with examinees the intended use of AI during the exam throughout the exam process, including in status update meetings and the exit meeting.

www.namic.org

Thank you again for your consideration of our comments and do not hesitate to reach out to me with any questions you may have.

Colleen Scheele

Colleen Scheele
Senior Vice Policy President and Counsel, Tax and Fiscal Policy
National Association of Mutual Insurance Companies

American Property Casualty Insurance Association
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November 13, 2025

Eli Snowbarger, Co-Chair
John Litweiler, Co-Chair
Financial Examiners Handbook (E) Technical Group
National Association of Insurance Commissioners

VIA ELECTRONIC SUBMISSION

Elise Klebba
NAIC
Eklebba@naic.org

RE: Financial Examiners Handbook (E) Technical Group Exposure Drafts

Dear Mr. Snowbarger and Mr. Litweiler:

The American Property Casualty Insurance Association (APCIA)[1] appreciates the opportunity to comment on the Financial Examiners Handbook (E) Technical Group's proposed revisions to the *Financial Condition Examiners Handbook*.

APCIA is supportive of the proposed additions to the Handbook clarifying that examiners should not input any confidential information into AI platforms and that examiners should review and validate the accuracy, appropriateness, and relevance of AI outputs.

However, we believe there should be additional language added to the Handbook to include a requirement for examiners to notify insurers when AI will be used during an exam, as well as a short description of the program, how it will be utilized and the insurance department's security protocol. This would allow insurers and their IT teams to test and gain comfort with the AI tool prior to the exam. We believe that this is necessary at this moment, since AI use in this context is relatively new, developing quickly, and there are many AI tools being developed.

Should you have any questions, please contact us. Thank you for your consideration.

Sincerely,

Jay Muska

John (Jay) Muska, CFA, CPA
Vice President of Accounting and Financial Issues
American Property and Casualty Insurance Association

cc: D. Keith Bell
Chair, APCIA Financial Management and Regulation Committee

[1] APCIA is the primary national trade association for home, auto, and business insurers. APCIA promotes and protects the viability of private competition for the benefit of consumers and insurers, with a legacy dating back 150 years. APCIA members include companies of all sizes, structures, and regions—protecting families, communities, and businesses in the U.S. and across the globe.

EXAMINATION REPOSITORY – CAPITAL AND SURPLUS

Own Risk and Solvency Assessment (ORSA)

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

Annual Statement Blank Line Items

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

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

Relevant Statements of Statutory Accounting Principles (SSAPs)

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

No. 41 — Surplus Notes
No. 72 — Surplus and Quasi-reorganizations

† Risks identified with this symbol may warrant additional procedures or consideration at the head of the internationally active insurance group (IAIG) or level at which the group manages its aggregated risks. Where IAIGs have a decentralized business model, at least in regard to certain operations and management of related risks, examiners should consider evaluating those risks at the subgroup or legal entity level. Refer to Section 1, Part I for additional guidance for examinations of IAIGs.

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
Other Than Financial Reporting Risks						
Text Eliminated to Conserve Space						
Financial Reporting Risks						
Text Eliminated to Conserve Space						
The insurer is not accurately calculating, reporting and monitoring RBC, including any manual adjustments to RBC charges (i.e., modified coinsurance [modco] reinsurance, separate accounts, etc.).	OP	CM	CMT	RBC calculations are performed in accordance with instructions and subject to supervisory review. The company has a process to ensure that RBC reports and supporting data are filed with the NAIC in a timely and complete manner. The company reconciles data filed in support of the RBC calculation (including any manual adjustments) back to system data and/or source documentation. The company utilizes the same modeling approach, assumptions and data to	Test controls relating to the insurer's supervisory review process for RBC. Review the NAIC RBC crosscheck letter from the insurer or the NAIC, if applicable, and response letter from the insurer to determine the completeness and accuracy of the insurer's RBC report. Contact the NAIC quality assurance department if such correspondence is unavailable. Test the insurer's reconciliation of supporting data back to the system and/or source documentation. Test the operating effectiveness of company controls to verify that	Obtain and review the insurer's supporting workpapers to test whether material values in the RBC report were properly classified, valued and included (e.g., catastrophe risk exposure data, C-3 Phase II, modco reinsurance adjustments, separate account assets) in accordance with SSAP guidance and RBC instructions. Compare the data provided in the RBC filing against other filings (e.g., Schedule S Part 8 for modco reinsurance) and information available to the department for consistency and reasonableness. (This procedure may only be necessary for values not obtained directly from the annual financial statement and not subject to the NAIC RBC crosscheck procedures.)

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				determine significant components of its RBC charge (e.g., catastrophe risk exposure, C-3 Phase II) as it uses for its own internal risk management and regulatory accounting/reserving purposes.	modeling approaches, assumptions and data used to determine significant components of RBC charges are reconciled/agreed to those used in internal risk management and accounting/reserving processes.	Determine the impact of examination changes on the RBC calculation. Compare the modeling approaches, assumptions and data filed in support of RBC calculations with those used by the company for internal risk management and regulatory accounting/reserving purposes (including interrogatories, actuarial filings, AS exhibits, etc.). Investigate any significant variances or inconsistencies for appropriateness.

EXAMINATION REPOSITORY – REINSURANCE (CEDING INSURER)

Annual Statement Blank Line Items

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

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

Risk-Based Capital (RBC) Filing

RCAT (PR027) may be used to identify and assess the insurer's current exposure to catastrophic events at the modeled worst year in 50, 100, 250, and 500 levels on both a gross (direct and assumed) and net basis (after reinsurance).

Relevant Statements of Statutory Accounting Principles (SSAPs)

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

No. 5 — Liabilities, Contingencies, and Impairments of Assets
No. 25 — Affiliates and Other Related Parties
No. 61 — Life, Deposit-Type and Accident and Health Reinsurance
No. 62 — Property and Casualty Reinsurance
No. 63 — Underwriting Pools
No. 64 — Offsetting and Netting of Assets and Liabilities
No. 65 — Property and Casualty Contracts

† Risks identified with this symbol may warrant additional procedures or consideration at the head of the internationally active insurance group (IAIG) or level at which the group manages its aggregated risks. Where IAIGs have a decentralized business model, at least in regard to certain operations and management of related risks, examiners should consider evaluating those risks at the subgroup or legal entity level. Refer to Section 1, Part I for additional guidance for examinations of IAIGs.

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
Other Than Financial Reporting Risks						
*****Text Eliminated to Conserve Space*****						
The insurer is over-exposed to credit and liquidity risks in its use of reinsurance counterparties. †	CR LQ	Other	AARP	The insurer has policies in place requiring utilization of multiple reinsurers to reduce concentration with any one entity. The insurer has a process to approve reinsurance counterparties. The insurer has a process in place to preapprove and set maximum limits to be ceded to reinsurers that are monitored and revised, as necessary. The insurer continually monitors the financial solvency of its reinsurers throughout the duration of the reinsurance contracts. Collateral is held in association with significant treaties to encourage prompt	Test the operating effectiveness of the insurer's controls to track compliance with the concentration policy. Obtain evidence of the insurer's process to approve reinsurance counterparties and to determine the credit worthiness of counterparties. Obtain evidence of the pre-approval process and documentation of maximum reinsurance limits. Obtain evidence of the insurer's ongoing review of its reinsurers. Obtain evidence of the insurer's process to consider/require collateral	Based on a review of significant contracts, determine whether the insurer is properly diversified. Perform procedures to evaluate the quality of significant reinsurers utilized by the insurer; for example: • Review agency ratings • Review financial results Contact the domestic regulator regarding any concerns. For select reinsurers, verify that the balance currently ceded is within the maximum limits set by the insurer. Review the liquidity of the assets used to secure the collateral and verify that these assets are correctly attributed to the reinsurers. Review the assets held for collateral in Modco and

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				settlement and fulfillment of obligations. Where collateral is held related to Modco or Funds Withheld (FWH) reinsurance (life/A&H insurers), the reinsurance agreement includes guidelines and limits for the reinsurer regarding investments and overall credit quality of the collateral assets, as well as affiliated/related party considerations. The insurer has procedures in place to continually monitor the performance of the collateral assets.	to be held for significant treaties. Obtain the reinsurance agreement to validate the insurer has set forth guidelines/limits regarding the investments and overall credit quality of the collateral assets, as well as affiliated/related party considerations. Obtain evidence of the insurer's ongoing understanding and review of the collateral assets held and their performance.	FWH reinsurance agreements (see information in Schedule S – Part 8 and Note to the Financials #5L) for reasonableness and assess the credit quality of the assets held, individually and in the aggregate. Verify that the collateral held and affiliated/related party concentrations of the reinsurer aligns with the guidelines laid out in the Modco/FWH reinsurance agreement.
Financial Reporting Risks						
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EXAMINATION REPOSITORY – INVESTMENTS

Annual Statement Blank Line Items

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

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

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

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

*****Text 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						
Text Eliminated to Conserve Space						
The insurer is not properly implementing, reporting and monitoring structured security transactions. **Please note:** If the company appears to have significant structured security holdings, consider engaging a specialist to conduct a portfolio analysis to assist in identifying and assessing risks in this area.	MK CR	Other	AIPS VIIA	The insurer has a plan in place that documents the following for its structured security portfolio: • Strategy. • Relation to products. • Senior management review and board of directors (or committee thereof) oversight. • Major adverse factors and frequency of stress testing	Determine whether management has adequately reviewed the insurer's non-agency structured security portfolio for the following risks: • Complex cash-flow structures (including interest-only and prepayment support structures). • Sub-prime borrowers within the underlying assets (e.g., mortgage loans, auto loans, credit cards, etc.). • Collateral type concentration. • Subordination in the overall structure of the transactions. • Trend analysis (underlying assets).	If necessary, use an investment specialist to analyze the insurer's structured securities portfolio. Review a sample of structured securities to test for proper valuation and reporting. For example, review a sample of financial and non-financial ABS securities reported on Schedule D, Part 1, Section 2 of the annual statement to verify the security qualifies as a bond under the Principles-Based Bond Definition and applicable SSAP standards.

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				Management reviews and considers prepayment volatility and cash-flow variability with regards to mortgage-backed securities in implementing its investment strategy. The insurer has a process in place to understand the reporting and valuation techniques discussed in SSAP No. 43 for complex structured securities. The company: • Has a process in place to determine if the security qualifies for bond reporting treatment under the Principles-Based Bond Definition. • Maintains underlying analysis that supports reporting financial and non-financial ABS as bonds (on Schedule D, Part 1, Section 2) as	Review the insurer's process to determine the proper reporting and valuation of complex structured securities. Obtain and review the company's underlying analysis to verify that financial and non-financial ABS are properly reported.	

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				opposed to other assets (Schedule BA).		
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EXAMINATION REPOSITORY – RESERVES/CLAIMS HANDLING (LIFE)

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. 5 — Liabilities, Contingencies, and Impairments of Assets
No. 50 — Classifications of Insurance or Managed Care Contracts
No. 51 — Life Contracts
No. 52 — Deposit-Type Contracts
No. 54 — Individual and Group Accident and Health Contracts
No. 55 — Unpaid Claims, Losses and Loss Adjustment Expenses
No. 61 — Life, Deposit-Type and Accident and Health Reinsurance
No. 63 — Underwriting Pools

† Risks identified with this symbol may warrant additional procedures or consideration at the Head of the Internationally Active Insurance Group (IAIG) or level at which the group manages its aggregated risks. Where IAIGs have a decentralized business model, at least in regard to certain operations and management of related risks, examiners should consider evaluating those risks at the subgroup or legal entity level. Refer to Section 1, Part I for additional guidance for examinations of IAIGs.

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
Other Than Financial Reporting Risk						
Text Eliminated to Conserve Space						
Financial Reporting Risks						
Text Eliminated to Conserve Space						
The assumptions used by the insurer for high-yielding complex assets are not accurate or appropriate for use in meeting asset adequacy requirements. †	RV	VA AC	RA	The company maintains documentation supporting the assumptions used in determining asset adequacy of high-yielding complex assets, including: • Expected gross returns and related risk (including default rates). • Factors supporting the margin. • Extent to which high-yielding assets are supporting major product categories. • Rationale supporting changes in assumptions year over year, if applicable. The company performs sensitivity testing for high-yielding complex assets in accordance with *Actuarial*	Obtain and review the company's documentation and approval of work performed to support the assumptions used in determining asset adequacy of high-yielding complex assets. Obtain and review documentation describing inputs used in sensitivity testing for high-yielding	Use the insurance department actuary or an independent actuary to review assumptions and methodologies for reasonableness, appropriateness, accuracy, and compliance with the *Valuation Manual*. Perform stress testing/scenario analysis on the insurer's high-yielding complex assets (by using an investment or actuarial specialist if necessary) to identify potential solvency risks. Use the insurance department actuary or an independent actuary to evaluate the impact that a change in assumptions could have on the company's asset adequacy and solvency position. Review the company's applicable AG ~~53~~

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				Guideline LIII—Application of the Valuation Manual for Testing the Adequacy of Life Insurance Reserves (AG 53) requirements. The company performs attribution analysis and/or cash flow testing for asset intensive reinsurance transactions in accordance with *Actuarial Guideline LV – Application of the Valuation Manual for Testing the Adequacy of Reserves Related to Certain Life Reinsurance Treaties* (AG 55) requirements. The company has an internal process that is reviewed and approved by management for determining the fair value of high-yielding assets originated by the company, within the company's group, or with an entity closely tied to the company's group that includes: • Practices for valuing such assets. • Fair value determination.	complex assets, as well as the results of such testing. Obtain and review documentation describing assumptions utilized for cash flow testing, as well as the results of such testing and results of the attribution analysis. Obtain and review documentation of management's review and approval of the company's internal process for determining the fair value of high-yielding complex investments. Obtain and review documentation supporting the valuation of the company's high-yielding complex assets.	documentation for reasonableness Review the company's applicable AG ~~53~~ reporting to identify assumptions underlying the asset adequacy testing memorandum that appear to be outliers. Coordinate with the Valuation Analysis (E) Working Group of the NAIC regarding any reviews it has performed on the company's AG ~~53~~ filings.

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				• Contractual agreements and revenue sharing (e.g., performance fees between insurer and entity responsible for providing investments or other services). The company uses an independent actuarial firm (other than its appointed actuary) to periodically review its assumptions.	Review any third-party actuarial work to verify and substantiate the appropriateness of company assumptions.	
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INTRODUCTION

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B. Overview of Risk-Focused Surveillance Process

The intent of the risk-focused surveillance process is to broaden and enhance the identification of risk inherent in an insurer's operations and utilize that evaluation in formulating the ongoing surveillance of the insurer. This assessment could be completed on a legal entity basis or on an organization-wide basis depending on how the company structures its business. Through their activities, insurers assume a variety of risks, which is the essence of an insurance transaction. The type of risk and its significance varies by activity. Investment activities may involve credit risk, market risk and liquidity risk. In product sales, insurers may assume market risk, pricing/underwriting risk, strategic risk, or liquidity risk in varying degrees, depending on the product. Over the years, state insurance regulators have developed numerous tools to address the risks insurers assume. Investment laws limit the market and credit risk insurers can assume. Limitations on net retentions help reduce catastrophe risk. Risk-based capital requirements establish capital levels in recognition of a variety of risks. Insurance regulators have always considered the risk profiles of licensed insurers and the activities that may pose risk to the company in the future. The risk-focused surveillance process utilizes an organization-wide risk assessment process to enhance evaluation and to better coordinate the activities of financial solvency surveillance through greater consistency within the department, and with other departments.

A risk-focused surveillance process includes identifying significant risks, assessing and analyzing those risks, documenting the results of the analysis, and developing recommendations for how the analysis can be applied to the ongoing monitoring of the insurer. This increased attention by regulators to risk assessment and risk management processes utilized by insurers will be a positive development.

The enhancements included in the risk-focused surveillance process intend to provide the following benefits:

1. Strengthen regulatory understanding of the insurer's corporate governance function by documenting the composition of the insurer's board of directors and the executive management team as well as the quality of guidance and oversight provided by the board and management.

2. Enhance evaluation of risks through assessment of inherent risks and risk management processes regarding weaknesses of management's ability to identify, assess and manage risk.

3. Improve early identification of emerging risks at individual insurers on a sector-wide basis.

4. Enhance effective use of regulatory resources through increased focus on higher risk areas.

5. Increase regulatory understanding of the insurer's quality of management, the characteristics of the insurer's business and the risks it assumes.

6. Enhance the value of surveillance work and establishment of risk assessment benchmarks performed by insurers and regulators, who have common interest in ensuring that risks are properly identified, and that adequate, effective control systems are established to monitor and control risks.

7. Better formalize and document the risk assessment process via the use of risk assessment tools (i.e., risk assessment matrix), or within the electronic workpaper application.~~ including the risk assessment matrix tool or the TeamMate+ system, the risk assessment matrix tool ~~to assist in examination planning and resource assignment.

8. Expand risk assessment to provide a more comprehensive and prospective look at an insurer's risks through identification of the insurer's current and/or prospective high-risk areas.

9. Coordinate the results of the risk-focused examination process with other financial solvency surveillance functions (i.e., establishing/updating the priority score and supervisory plan).

In full, the risk-focused surveillance process provides effective procedures to monitor and assess the solvency of insurers on a continuing basis. The risk-focused surveillance process is embedded in the planning activities and throughout each phase of the risk-focused surveillance process discussed in detail within this Handbook. The revised approach consists of a structured methodology designed to establish a forward-looking view of an insurer's risk profile and the quality of its risk management practices. This approach permits a direct and specific focus on the areas of greatest risk to an insurer. Through this approach, state insurance regulators can be more proactive and better positioned to identify and respond to any serious threat to the stability of the insurance company from any current or emerging risks. This regulatory approach will benefit all participants in the insurance marketplace.

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D. Purpose of Risk-Focused Examinations

The intent of the risk-focused surveillance process in a risk-focused examination is to determine areas of higher risk to enable more efficient use of examiner resources. The primary purpose of a risk-focused examination is to review and evaluate an insurer's business processes and controls (including the quality and reliability of corporate governance) to assist in assessing and monitoring its current financial condition and prospective solvency. As part of this process, the examiner identifies and evaluates risks that could cause an insurer's surplus to be materially misstated, both currently and prospectively.

With these goals in mind, the risk-focused examination approach contains seven phases: (1) understanding the company and identifying key functional activities to be reviewed; (2) identifying and assessing inherent risk in activities; (3) identifying and evaluating risk-mitigation strategies/controls; (4) determining residual risk; (5) establishing/conducting examination procedures; (6) updating prioritization and supervisory plan; and (7) drafting the examination report and management letter based on findings. The risk assessment should be documented to reflect planning progress, examiner impressions, and results. ~~The Risk Assessment Matrix is introduced as a tool that should be utilized to document the risk assessment planning progress, impressions, and results.~~ The regulator may also consider preparing a risk assessment narrative to summarize and detail the findings of the risk assessment.

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E. Risk-Focused Examination Process

The concept of risk considered in examinations had historically focused on the static risk of a material misstatement of the financial condition of the company at a given point in time. The concept of risk considered in a risk-focused examination encompasses not only risk as of the examination date, but risks which extend or commence during the time which the examination was conducted, and risks which are anticipated to arise or extend past the point of completion of the examination. As such, risks in addition to the financial reporting risks may be reviewed as part of the examination process. The timing of the risk assessment during the examination has also changed as a result of the adoption of the risk-focused examination. Risk assessment has historically occurred as part of the planning process. The risk-focused examination anticipates that risk assessment may extend through all seven phases of the examination discussed below as well as link to the work carried forward by the financial analysis function.

The following chart and Handbook sections discuss the seven phases necessary to conduct a risk-focused examination. The methodology emphasizes a "risk-focused" approach whereby resulting examination fieldwork will analyze an insurer's solvency risk areas in addition to the risks associated with the fair presentation of surplus. The examiner-in-charge should use the risk assessment documentation, ~~such as the Risk Assessment Matrix (Exhibit K), matrix (or similar document) as a tool~~ to ~~document~~ determine the allocation of exam resources (by the identification of key functional activities and sub-activities) to be assessed. The approach used will be influenced by the size, complexity, and effectiveness of the overall insurer's risk control environment. A flowchart of the seven phases of a risk-focused examination follows and is described in detail later in this Handbook:

See Exhibit K for the Risk Assessment Matrix tool and the linkage to the seven phases.

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G. Confidentiality

The NAIC Model Law on Examinations (or a substantially similar provision) is required to be part of state law in accordance with accreditation guidelines. This Model Law provides specific guidelines regarding the confidentiality of information developed, received, or disclosed through the course of conducting financial and market conduct examinations, including the course of analysis. As detailed within this Model Law, documents, materials, or other information, including but not limited to all working papers, and copies thereof, created, produced or obtained by or disclosed to the commissioner or any other person in the course of an examination, or in the course of analysis by the commissioner of the financial condition or market conduct of a company shall be confidential by law and privileged and shall not be subject to public disclosure, shall not be subject to subpoena, and shall not be subject to discovery or admissible in evidence in any private civil action.

In accordance with the revised risk-focused surveillance approach contained within this Handbook, it is anticipated that the financial examiners will be incorporating new tools to document their examination approach and results (e.g., Insurer Profile Summary, r~~R~~isk a~~A~~ssessment tools~~Matrix~~, Supervisory Plan and Summary Review Memorandum). Similar to other documentation completed in accordance with a financial condition examination, these tools shall be considered confidential under state law including the state's examination law. Although the risk-focused examination approach envisions enhanced communication between state insurance department examiners and analysts, the sharing (and potential further development) of these examination workpapers to and by financial analysis regulators, or to other individuals within a state insurance department, shall not impact their confidential status. All examination workpapers, including those mentioned above may be shared with other regulators whose state insurance departments have the authority under state law to preserve the confidentiality of the information they receive. (The confidentiality provisions related to examination workpapers apply to both examinations of insurance companies and holding companies.)

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I. EXAMINATION OVERVIEW

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J. Interim Work

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2. Conducting Interim Work

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Use of Key Activity Matrices/Exhibit V – Overarching Prospective Risk Assessment

For current and prospective risks, interim work performed should be documented within the key activity risk assessment ~~key activity matrix~~ and/or Exhibit V ~~should be used to document interim work performed~~. For risks placed on Exhibit V, all columns should be completed in accordance with the guidance in the exhibit. This includes review of mitigation strategies, obtaining corroborating evidence and performing follow-up procedures. For risks ~~placed on~~recorded in a ~~key activity matrix~~key activity risk assessment, each phase should be evaluated and completed in accordance with the risk-focused approach. Interim work will typically place more emphasis on the review of controls/risk mitigation strategies because of the relative ease of rolling-forward and relying on this work in future periods, as opposed to the challenges in rolling-forward substantive tests of balances performed at a particular point in time. Because of the need to effectively roll-forward all interim work, if control deficiencies are identified, these concerns should be communicated to the company with an expectation they will be resolved prior to the full-scope examination. If the control deficiencies are not resolved prior to the full-scope examination or the examiner is unable to verify the resolution, the examiner may need to re-perform substantive procedures at the end of the full-scope examination period to ensure adequate coverage of the risk.

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3. Utilizing Interim Work in the Full-Scope Examination

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Key Activity Matrices/Exhibit V – Overarching Prospective Risk Assessment

Interim work may be performed in response to a risk or series of risks that will be ~~assessed~~evaluated ~~on~~ through a key activity ~~matrix~~ risk assessment or Exhibit V. When this occurs, the work performed at interim may address some or all of the risks identified for review in the full-scope examination for a particular key activity or on Exhibit V. For identified risks addressed at interim for a particular key activity or prospective risk, the examiner should determine whether any updates to the test work or conclusions reached at interim are necessary. If control deficiencies were identified, the examiner should verify the deficiencies were appropriately resolved in order to fully rely on the conclusions reached at interim or perform substantive procedures at period end if issues are not resolved. Additional work may also need to be considered if there have been changes in the exposure, key processes, employees, etc. This conclusion should be clearly documented in the examination file along with the interim workpapers upon which reliance is placed and any additional testing performed to supplement interim work in light of changes.

In addition to the documentation requirements outlined above, if the examiner identifies other risks that need to be reviewed beyond those addressed in interim procedures, such risks should be added to the exam file and addressed through the full seven-phase examination process as a supplement to the interim work performed. Such work should be presented separately from interim work (i.e., separate ~~matrix~~ assessment ~~or tab~~) to make it clear when various risks were addressed during the examination and which risks were subject to roll-forward review. In every examination, strong consideration should be given to identifying and addressing additional overarching prospective risks on Exhibit V beyond those addressed at interim.

Critical Risk Categories

Exhibit DD – Critical Risk Categories is required to be completed for each full-scope examination, but the categories may be addressed through work performed at interim or at the conclusion of the full-scope examination. In all cases, the Exhibit must include references to where work addressing related risks is located in the full-scope examination file, and all interim work related to critical risks must be subject to adequate roll-forward review as discussed above.

Examination Reports

The examination report is issued upon completion of a full-scope examination and may be supported by procedures performed at various points during the examination period. In order to accurately represent the information obtained to support examination conclusions, elements of the report may require modification if reliance is placed on interim work as follows.

> *Reference to Interim Work in Full-Scope Examination Report* – When interim work is utilized in support of the full-scope examination conclusions, reference to such work should be made in the scope section of the examination report. Following is an excerpt from Section 2, Phase 7A.2.c demonstrating with the underlined sentence how this reference can be incorporated.
>
> All accounts and activities of the company were considered in accordance with the risk-focused examination process. This may include assessing significant estimates made by management and evaluating management's compliance with statutory accounting principles. As permitted by the *Financial Condition Examiners Handbook*, some of the work performed in support of the conclusions in this examination report was performed within the reporting period on an interim basis. The examination does not attest to the fair presentation of the financial statements included herein. If, during the course of the examination an adjustment is identified, the impact of such adjustment will be documented separately following the company's financial statements.

Impact of Findings/Exam Adjustments Identified in Interim – The content of the examination report should be consistent with guidance in Section 2, Phase 7, and should include significant findings of fact for issues identified during the interim period and the full-scope examination work. Findings identified as a result of interim work should be identified as such and include a brief discussion on whether items have been adequately resolved or remain a concern at the end of the examination period.

III. GENERAL EXAMINATION CONSIDERATIONS

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C. Examination Sampling

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a. Determining Reliance on Audit Procedures

Audit workpapers can be used extensively to enhance the efficiency of an exam. The Phase 1 guidance in Section 2 of the Handbook assists examiners in developing an understanding of the company and offers guidance for determining whether the work of auditors can be used to reduce the review of financial reporting risks. If the audit function is deemed effective, it may be appropriate to eliminate certain low to moderate financial reporting risks addressed by the auditor from a detailed review through the examination process. In these situations, it would not be necessary for the exam team to document a detailed review of sampling techniques utilized by the auditors to test these risks. However, if the examiner determines that specific financial reporting risks tested by the auditor are significant (moderate to high risks) or will be used to address a relevant critical risk category, the examiner should subject these risks to the full examination process ~~by~~ by documenting and reviewing them under the relevant key activity risk assessment.~~placing them on a key activity matrix for review~~. In reviewing and testing these risks through the risk assessment process ~~on the risk matrix~~, the examiner may still choose to place reliance on test work and sampling procedures conducted by the auditor, but such work would be subject to detailed review and documentation in the exam file in Phase 3 or 5.

In reviewing audit workpapers for use in Phase 3 or 5, the examiner should ensure that the audit testing objectives align with the testing objectives established by the examiner. The examiner should also consider the auditor's intended level of reliance when determining the sufficiency of the sample size. If the examiner intends to place the same amount or a lower level of reliance on a test than was placed by the auditor, the sampling procedures employed by the auditor may be deemed sufficient if they meet the examiner's expectations and are adequately documented. However, if the examiner intends to place more reliance on a test procedure than was placed by the auditor, additional sample selections or alternate procedures may be required to provide sufficient supporting evidence. In these situations, the sampling guidance provided below may be used to assist in leveraging audit work ~~on~~ in a key activity ~~matrix~~ ~~assessment~~risk assessment ~~level~~ and/or determining the amount of additional sample selections needed to obtain sufficient exam evidence.

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E. Using the Work of a Specialist

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4. Documentation of Work Performed by the Specialist

The examiner-in-charge should communicate with the specialist as to the appropriate documentation of the work performed by the specialist. It should be determined upfront with the specialist who is responsible for the completion of the risk ~~matrix~~ assessment and supporting documentation. Regardless of who is responsible for completing the risk assessment~~matrix~~ in a particular area, the work performed is required to clearly document a consideration of all seven phases of the risk-focused examination process.

The work should also be completed in accordance with the guidance outlined in the standard examination procedures regarding examination documentation, including sufficient documentation on all conclusions.

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G. Use of Independent Contractors on Multi-State Examinations

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Depending on the scope of the engagement and extent of the work performed by the independent contractor, the following standards of examination planning, fieldwork, and examination reports are applicable:

1. Standards of Examination Planning and Field Work

   a. The procedures shall be planned and developed according to the Handbook under the supervision and with the participation of the insurance department's designee. This includes review and approval of the examination planning memorandum, which may also warrant a review of workpapers supporting the conclusions reached therein.

   b. The insurance department's designee shall review and approve significant examination workpapers on a timely basis. This includes, but is not limited to the following:
      - Applicable risk assessment workpapers, including the examination risk tracker (Exhibit CC), prospective risk assessment (Exhibit V), key activity ~~matrices~~ risk assessments and consideration of critical risk categories (Exhibit DD).
      - Ongoing examination status and explanation of modifications to the approved time budget.

   c. The insurance department's designee shall supervise all significant field work activities, including appropriate review and approval of risks identified and planned procedures prior to beginning Phase 3 and Phase 5.

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

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

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

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

One crucial aspect to a successful planning process is the tailoring of planning procedures to the company under review. As the exam team learns about risks, subsequent planning procedures should be tailored to ensure that they provide further information on the risks already identified. For instance, if after meeting with the Department's analyst, the examination identifies a risk related to the company's planned expansion of business into new jurisdictions, subsequent procedures performed in planning—i.e., "C"-Level Interviews, review of company ERM, etc.—should be tailored to include consideration on the risk.

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

~~be updated with the identified key activities of the company after the examiner is able to obtain an understanding of the company and corporate governance structure.~~ The five parts of Phase 1 are discussed as follows:

A. Part 1: Understanding the Company
B. Part 2: Understanding the Corporate Governance Structure
C. Part 3: Assessing the Adequacy of the Audit Function
D. Part 4: Identifying Key Functional Activities
E. Part 5: Consideration of Prospective Risks for Indications of Solvency Concerns

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D. Part 4: Identifying Key Functional Activities

To ensure the appropriate risk-focused examination scope, it is important to identify the key functional activities (i.e., business activities) of the company. The information gathered to this point will form the basis for this determination. Note that the list of functional activities may include both other than financial reporting (operating) and financial reporting risks. The insurance organization may be examined on the same basis, as it manages risk and controls itself, so that functional activities listed ~~on~~ in the risk assessment~~a risk matrix)~~ would correspond organizationally to the insurer.

When determining what to select as key functional activities, the examiner should perform a preliminary analysis of the overall materiality of an activity. The examiner should carefully consider the risk of understatement when reviewing the materiality of liability balances. If the examiner determines that a particular activity does not currently appear to be material but could represent a significant prospective solvency risk to the company, the activity should be selected as key and walked through the seven-phase examination process. In all cases, the examiner should document the reasoning behind key activity selection in the examination planning memorandum.

E. Part 5: Consideration of Prospective Risks for Indications of Solvency Concerns

In addition to conducting an examination to verify the current status of the company's solvency condition, the risk assessment surveillance cycle requires examiners to prospectively consider the company's financial condition by assessing whether the company's current processes provide indications of future solvency concerns. In conducting examinations based on the risk-focused surveillance framework, the examiner should give consideration to the business processes and management controls that often are considered retrospectively after financial issues indicate that a company has potential financial solvency issues. In addition to assessing business risks, other elements that would commonly be assessed for prospective solvency risks include consideration of the company's asset/liability matching approach, process for establishing loss reserves, pricing and underwriting, and reinsurance arrangements. Among other things, these assessments should include consideration of the company's rate of growth and whether the liquidity of assets would create future concerns about the company's financial solvency.

This approach will allow the examiner to review risks that existed at the examination "as of" date and will be positioned to assess risks that extend or commence during the time the examination was conducted and risks that are anticipated to arise or extend past the point of examination completion. How the examiner addresses the prospective risk noted during the examination depends on the nature of the prospective risk itself.

By the end of Phase 1 of the examination, the examination team should have completed a high-level review of the insurer to identify any solvency concerns that commenced or extended after the examination date, or that are anticipated to commence or extend beyond the examination completion date. Such concerns may be identified through various aspects of the planning process, such as C-level interviews, review of Form F – Enterprise Risk Report, input from the analyst, review of the most recent Form 10-K, etc. 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 (or similar documentation)~~ assessment for that key activity and should be treated the same as all other identified risks. As such, examples of risks that an examiner may want to consider in assessing prospective solvency concerns related to common key activities have been included within the examination repositories. 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 Exhibit V – Overarching Prospective Risk Assessment to document the process to consider these prospective risks.

By the end of Phase 1, the examiner should have a preliminary listing of overarching prospective risks included on Exhibit V. Prospective risks may continue to be identified beyond Phase 1. Any 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. For additional guidance on identifying and investigating overarching prospective risks during the examination, see the instructions on Exhibit V – Overarching Prospective Risk Assessment.

The examiner should complete Exhibit CC – Issue/Risk Tracking Template or a similar document to show how significant solvency risks have been identified and accumulated through the planning process. Significant issues/risks on Exhibit CC should be considered for further evaluation during the examination, either through Exhibit V, a key activity ~~matrix~~ risk assessment or the examination planning memo.

PHASE 2 – IDENTIFY AND ASSESS INHERENT RISK IN ACTIVITIES

At the end of Phase 1, the key activities requiring examination have been determined as part of the planning process. These are outlined as follows:

A. Identifying the Risk
B. Identifying the Type of Risk
C. Assessing the Inherent Risk
D. Reviewing Inherent Risks and Finalizing Examination Planning

A. Identifying the Risk

Risks Other Than Financial Reporting

In Phase 1, key functional activities were identified and documented as part of the risk assessment process. ~~captured in the Risk Assessment Matrix (or similar documentation).~~ Phase 2 requires the examiner to identify specific risks of the key activities ~~captured~~ that are related to business and prospective risks. The examiner should consider potential events that, if they occur, may affect the entity when determining risks. As stated in Phase 1, these risks would be included ~~on~~in the ~~R~~risk ~~A~~assessment documentation~~-. Matrix (or similar documentation).~~ These risks may require that detailed examination procedures are performed or that the risks be communicated to the financial analysts for ongoing monitoring and use in the supervisory plan. The examiner may identify risks through various means, such as leveraging ~~off of~~ the insurer's own risk assessment, interviewing management and utilizing any other source that may assist in identifying risk. Exhibit CC – Issue/Risk Tracking Template or a similar document should be completed to show how issues noted in Phase 1 were incorporated into the process to accumulate and identify risks. The reference materials discussed in Phase 1 can also be helpful to the examiner in identifying other than financial reporting risks. The r~~R~~isk a~~A~~ssessment documentation~~,~~ will serve as the central location for recording the assessment and conclusions related to identified risks.~~Matrix (or similar documentation), however, will be the central location for the documentation of risk assessment and conclusions related to these risks.~~

Financial Reporting Risks

In Phase 1, key functional activities were identified and documented as part of the risk assessment process. ~~and captured in the Risk Assessment Matrix (or similar documentation).~~ Phase 2 requires the examiner to identify risks of the key activities that are related to financial reporting and determine what the specific inherent risk is. To identify the components of risk for each key activity, the examiner may rephrase examination assertions or financial statement assertions into risk statements for the related activity. For example, within the key activity of investments, one of the relevant financial statement assertions is valuation. This methodology suggests turning that assertion into a risk statement; e.g., the value of investments is overstated in the financial statements. The ensuing inherent risk assessment will be conducted based on this risk statement (i.e., what is the likelihood and impact of securities being overstated). This is what makes the process risk-driven or risk-focused. Rephrasing examination assertions into risk statements is only the starting point in identifying risk. The examiner may identify risks through various means, such as leveraging off of the insurer's own risk assessment; utilizing internal and external audit's risk assessments; utilizing filing requirements of the SEC and SOX (Sections 302 and 404); reviewing 10-K filings; performing interviews with management; reviewing results of preliminary analytical review procedures; and using any other source that may assist in identifying risk. Exhibit CC – Issue/Risk Tracking Template or a similar document should be completed to show how issues noted in Phase 1 were incorporated into the process to accumulate and identify risks. ~~The risk statement~~Risk statements (identification of the risks for each of the key activities) ~~is listed in the Risk Assessment Matrix (or similar documentation).~~should be documented as part of the risk assessment process.

B. Identifying the Type of Risk

Risks Other than Financial Reporting and Financial Reporting Risks

After ~~the examiner populates includes~~ the relevant risks have been identified ~~risks within~~ for inclusion in the r~~R~~isk a~~A~~ssessment~~, Matrix (or similar documentation) with identified risks,~~ the examiner must assign at least one of the nine branded risk classifications below to each identified risk. ~~At least one of the nine risk classifications should are to be associated with each identified in the Risk Assessment Matrix (or similar documentation) for each specific risk identified.~~ Note that more than one of the nine branded risk ~~types~~ classifications may be applicable to a particular identified risk~~; and, as such, more than one branded risk type classification may be listed in theassigned to a single risk.~~ ~~branded risk column of the Risk Assessment Matrix (or similar documentation).~~ However, it is not necessary to identify the level of inherent risk for each of the nine branded risks classifications. ~~The process is driven by the risk identified in the risk statement of the activity and the controls used to mitigate that risk.~~ The branded risk classifications ~~allow for a summary of~~summarize the major types of risks in each of the key activities. ~~Each inherent risk identified should be associated with at least one of the following risk classifications:~~

1. Credit – Amounts actually collected~~,~~ or collectible~~s~~ are less than those contractually due or payments are not remitted on a timely basis.

2. Legal – Non-conformance with laws, rules, regulations, prescribed practices or ethical standards in any jurisdiction in which the entity operates will result in a disruption in business and financial loss.

3. Liquidity – Inability to meet contractual obligations as they become due because of an inability to liquidate assets or obtain adequate funding without incurring unacceptable losses.

4. Market – Movement in market rates or prices, such as interest rates, foreign exchange rates, or equity prices adversely affect the reported and/or market value of investments.

5. Operational – The risk of financial loss resulting from inadequate or failed internal processes, personnel and systems, as well as unforeseen external events.

6. Pricing/underwriting – Pricing and underwriting practices are inadequate to provide for risks assumed.

7. Reputation – Negative publicity, whether true or not, causes a decline in the customer base, costly litigation, and/or revenue reductions.

8. Reserving – Actual losses or other contractual payments reflected in reported reserves or other liabilities will be greater than estimated.

9. Strategic – Inability to implement appropriate business plan, to make decisions, to allocate resources or to adapt to changes in the business environment will adversely affect competitive position and financial condition.

See Exhibit L for guidance that relates the above branded risk classifications to risk areas that correlate to an insurer's key activities and financial statement areas. This guidance will assist the examiner ~~to~~ in determining~~e~~ the level of inherent risk. See Section 3 – Examination Repositories for examples of risks that fit into one of the nine branded risk classifications. The branded risk classifications should also be assigned to each prospective risk identified on Exhibit V – Overarching Prospective Risk Assessment and will assist in communications with the financial analyst.

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C. Assessing the Inherent Risk

Risks Other Than Financial Reporting and Financial Reporting Risks

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The "overall inherent risk assessment" is determined by taking into account the likelihood of occurrence, the magnitude of impact and the examiner's professional judgment. Overall inherent risk may be assessed as high, moderate or low. This assessment should be documented as part of the risk assessment process. ~~is placed in the Risk Assessment Matrix and the~~ The Overall Inherent Risk Rating Scale shown below provides guidance to assist in assessing inherent risk.

Overall Inherent Risk Rating Scale

Likelihood of Occurrence	Magnitude of Impact: Threatening	Severe	Moderate	Immaterial
High	High	High	High	Moderate
Moderate-High	High	High	Moderate	Moderate
Moderate-Low	High	Moderate	Moderate	Low
Low	Moderate	Moderate	Low	Low

The definitions for these rankings are as follows:

1. High Inherent Risk – The business activity is significant and/or transactions are large in relation to the company's financial strength. The number of transactions and/or the complexity/volatility of the business activity (particularly underwriting risks) appears higher than normally encountered or requires competent management expertise. In this context, the business activity potentially could result in a significant and harmful loss to the organization.

2. Moderate Inherent Risk – The business activity is significant, but transactions are moderate in size in relation to the company's financial strength. The number of transactions and/or the complexity/volatility of the business activity (particularly underwriting risks) are considered more easily manageable. Thus, the business activity could result in a loss to the insurer, but the loss could be absorbed in the normal course of the business.

3. Low Inherent Risk – The nature, transaction volume, size, volatility and/or complexity of a business is such that a loss would either be remote or have an insignificant negative impact on the insurer's financial strength.

Once the overall inherent risk assessment has been determined, the examiner should reevaluate whether all risks assessed as low should ~~remain on the Risk Assessment Matrix and~~ proceed through the risk-~~focused~~ assessment process. For example, a risk with a low likelihood of occurrence and an immaterial magnitude of impact may not be a significant risk to the company; therefore, it may be appropriate for the examiner to remove the risk from the risk ~~matrix~~ assessment before proceeding to Phase 3. This will allow the examiner to focus exam resources on the more significant risks of the company.

D. Reviewing Inherent Risks and Finalizing Examination Planning

After inherent risks have been identified and assessed for each key activity, the risks selected should be reviewed for adequacy and completeness. One of the goals of a risk-focused examination is to focus on the most critical solvency risks facing an insurer. To assist the examination team in meeting this goal, a list of critical risk categories has been developed for consideration in reviewing the adequacy of risk statements developed for review on each examination. This list of critical risk categories and the corresponding documentation template (see Exhibit DD – Critical Risk Categories) should be utilized to demonstrate that all critical risks facing the insurer have been selected for review. To the extent that an individual critical risk category is not deemed relevant for review, rationale for this decision should be provided within the exam planning memorandum.

Proper risk analysis and planning of an examination are essential to the development of an effective examination plan. A thorough understanding of the company's businesses and of the effects of significant changes, trends and current events is critical to properly planning an examination. At the conclusion of Phase 2, the examiner should document results of the planning process through the completion of an exam planning memorandum. See Exhibit I – Examination Planning Memorandum for additional guidance regarding the topics that should be included in this memo. Planning documentation including the planning memo should be reviewed and approved by both the chief examiner (or designee) and the examiner-in-charge prior to the performance of control (Phase 3) test work.

If it is determined that certain detail procedures will be necessary for an identified risk, regardless of the risk mitigation strategies/controls that may or may not be in place, the examiner should consider completing the residual risk assessment for the particular identified risk in order to begin testing expeditiously. Generally, these would be risks that are material and have a high inherent risk which may require time-consuming procedures to be performed, regardless of the controls that may be in place. In order to accomplish this, the examiner should document the rationale for such decision in the exam planning memorandum. Approval of the memo should be received from the chief examiner, or designee, prior to detail test work. At the same time, as the examination procedures are being performed, risk mitigation strategies/controls may still continue to be evaluated in order to determine the final residual risk assessment and the additional examination procedures that may need to be performed.

In Phase 3, the examination team will identify and evaluate the risk management strategies and controls related to these inherent risks.

PHASE 3 – IDENTIFY AND EVALUATE RISK MITIGATION STRATEGIES (CONTROLS)

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B. Evaluating Risk Mitigation Strategies/Controls

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Risks Other Than Financial Reporting

Other-than-financial reporting risks are often associated with a qualitative aspect of a company, such as the adequacy of certain strategies or contractual duties used to carry out the company's operations or the possibility of some future event. As implied by the name, these types of risks may not have a direct financial impact to the company at the time of the examination; however, if management is not properly monitoring the risk, it could lead to a deficiency at some point in the future. Due to the nature of this type of risk, and the fact that a company may only have a strategy in place to monitor the risk—rather than a systematic, periodic measurement of the risk—the examiner's evaluation of the risk may require a greater emphasis on the testing of mitigation strategies in place. Because testing risk mitigation strategies/controls over risks other than financial reporting may provide the greatest evidence that a risk is ultimately mitigated, the examiner should consider:

1. The extent to which an insurer is able to manage all the risks inherent in its significant business activities and other major activities and, in particular, its ability to identify, assess and manage these risks.

2. The adequacy of the qualitative and quantitative assumptions implicit in the risk management process.

3. Whether risk policies, guidelines and limits at the insurer are appropriate and consistent with its significant business activities, management experience level and overall financial strength.

4. Whether the management information system and other forms of communication are consistent with the level of business activity and the complexity of products offered at the insurer, and whether such systems provide sufficient support to accurately monitor risk exposure and compliance with established limits.

5. The ability of management to recognize and accommodate new risks that may arise from the changing environment and to identify and address risks not readily quantified in a risk management process.

Additionally, with many other than financial reporting risks, the timing of the risk mitigation strategy may affect the nature of testing performed. When testing financial reporting risks, it is typically expected that the risk mitigation strategy be tested at the "as-of" date; however, for many other-than-financial reporting risks, it may be more appropriate to test the current practice. For example, it may be more appropriate to review a company's current investment strategy in order to determine its long-term adequacy, rather than the investment strategy in place at the "as-of" date. Further, there are circumstances when reviewing both time periods may be beneficial. Using the example above, it may be appropriate to review the investment strategy in place at the "as-of" date to gain assurance of the appropriateness of the strategy and its effect on the balance sheet at the "as-of" date, as well as the current investment strategy.

Results of the testing should be documented in the r~~R~~isk a~~A~~ssessment ~~Matrix (or similar documentation)~~ and should assist the examiner in determining an overall risk rating.

Financial Reporting Risks

Factors that should be considered during the testing of controls over financial reporting risk include whether the controls are (1) operating as expected; (2) being applied consistently throughout the entire period of reliance; (3) being performed on a timely basis; (4) encompassing all transactions; and (5) identifying errors.

Consideration should be given to work performed by external auditors to minimize work performed by the examiner. If external audit workpapers are utilized, testing may also be performed by the examiner to further substantiate whether controls are adequate and operating effectively. This can be achieved by retesting the work performed by the external auditors, performing original testing, or a combination thereof. There is no retesting requirement of auditors' workpapers and the extent of any retesting performed should be based on the amount of reliance the examiner is placing on the auditors' workpapers. Examiners should refer to the Examination Sampling guidance located in Section 1 of this Handbook for assistance with determining sample sizes.

Reliance on Control Testing Performed in Prior Years

An examiner may be able to rely on control testing performed in a prior period, whether that testing is documented in internal or external audit workpapers. Some auditors perform control testing on a cyclical basis and, as a result, the same controls are not always tested every year. In addition, internal audit work is often performed on a rotational basis and key activity controls may not be tested every year.

If an examiner plans to utilize control testing documentation from a year prior to the current examination as-of date, the examiner should obtain evidence that the control has not changed subsequent to the prior period testing. The more reliance that is placed on the prior period testing documentation received from external/internal auditors, the more examination evidence should be obtained. Verification that controls have not changed should be obtained by a combination of inquiry, observation, reperformance and examination of documents, and should be clearly documented in the examination workpapers. If controls have significantly changed since the prior period, the examiner should not utilize the prior period workpapers for that area as examination evidence.

Risk Mitigation Strategies/Controls Ratings – Once the examiner has completed the testing of internal controls, the examiner should determine an overall risk mitigation strategy/control rating. Regardless of the number of controls that exist for an inherent risk, only one overall rating should be assigned. The Risk Mitigation Strategy/Control Assessment ratings to be indicated in the ~~R~~risk ~~A~~assessment ~~Matrix (or similar documentation)~~ for other than financial reporting risks and financial reporting risks are:

- **Strong Risk Management** indicates that management effectively identifies and controls all material types of risk posed by the relevant activity. Management participates in managing the insurer's risks and ensures that appropriate policies and limits exist. The board of directors understands and reviews the policies and limits and requires that significant exceptions are reported by management to the board. Policies and limits are supported by risk monitoring procedures, reports and management information systems that provide accurate, timely and necessary information and analyses to make timely and appropriate decisions to changing conditions. Internal controls and audit processes and procedures are appropriate to the size and activities of the insurer. There are few exceptions to established policies and procedures, and none of these exceptions would likely lead to a material loss to the company. For financial reporting risks, this could be evidenced, in part, by few or no control deficiencies (see definitions in Phase 4).

- **Moderate Risk Management** indicates that the insurer's risk management processes, although largely effective, might be lacking to some modest degree. It reflects an ability to cope successfully with existing and foreseeable exposures that may arise in carrying out the insurer's business plan. Although the insurer may have some minor risk management weaknesses, these problems have been recognized and are being addressed. Overall, board oversight, management policies and limits, risk monitoring procedures, reports and management information systems are considered effective in maintaining a safe and sound managed company where the potential for economic loss does not appear significant. Risks are generally being controlled in a manner that does not require above-normal supervisory monitoring. For financial reporting risks, this could be evidenced, in part, by the existence of control deficiencies that are not considered to be significant or material weaknesses (see definitions in Phase 4).

- **Weak Risk Management** indicates risk management processes that are lacking in important ways and, therefore, are a cause for above-normal supervisory attention. Active participation in the oversight, establishment of pertinent policies and the provision of appropriate direction (and evaluation of performance) is lacking from senior management. The internal control system may be lacking in important respects, particularly as indicated by continued control exceptions or by the failure to adhere to written policies and procedures. The deficiencies associated in these systems could have a significant adverse impact on the potential for economic loss; the reputation of the insurer in the marketplace; or could lead to a material misstatement of its financial statements if corrective actions are not taken promptly by management. For financial reporting risks, this could be evidenced, in part, by the existence of significant control deficiencies and/or material weaknesses (see definitions in Phase 4).

In the event that an examiner has difficulty choosing between two ratings, the examiner may consider the strength of an insurer's overall corporate governance to help reach a decision. For example, if an examiner is wavering between moderate and strong control ratings after considering the nature of the controls in place and the evidence obtained through testing, an effective overall corporate governance environment should encourage the examiner to assess the rating as strong. Conversely, if the corporate governance at the insurer is in many ways ineffective, the examiner may choose to assess the rating as moderate. However, corporate governance practices cannot fully mitigate an individual risk unless they are directly related. If an examiner chooses to utilize overall corporate governance considerations to assist with the assessment of risk management, then he or she must document the rationale for that decision within the risk assessment ~~matrix~~. This documentation may contain references to specific items identified during the assessment of corporate governance completed as part of Phase 1.

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D. Examiner Use of Sarbanes-Oxley Documentation

The Public Company Accounting Oversight Board (PCAOB) is a private-sector, non-profit corporation, created by the federal Sarbanes-Oxley Act of 2002 (SOX), to oversee the auditors of public companies in order to protect the interests of investors and further the public interest in the preparation of informative, fair, and independent audit reports. The overriding goal of the U.S. Congress and the PCAOB is the reliability of the company's financial statements. To achieve reliable financial statements, the PCAOB has indicated that internal controls must be in place for public companies to ensure that:

- Records are accurate and fairly reflect transactions in and dispositions of a company's assets.
- Records of transactions are sufficient to prepare financial statements in accordance with generally accepted accounting principles.
- Receipts and expenditures are made only as authorized by management and directors.
- Steps are in place to prevent or detect theft, unauthorized use or disposition of the company's assets of a value that could have a material affect on the financial statement.

SOX requires management of public companies to make an assertion as to the adequacy of their financial reporting controls. As such, management is required to issue formal, risk-based assessments of the effectiveness of their financial reporting controls. In addition, the external auditor of public companies must attest and provide an opinion on the reliability of management's assertion of the adequacy of the financial reporting controls. Any available SOX ~~I~~information~~ available, either from public companies required to comply with SOX, or companies electing to voluntarily comply, as a result of these control testing activities related to the Act ~~should be utilized in completing the~~is~~ ~~financial reporting risks section of the ~~r~~R~~isk ~~A~~assessment~~. Matrix (or similar documentation)~~. Leveraging the significant SOX-driven financial reporting control assessment activities in companies should facilitate the similar risk assessment process for regulatory purposes.

The PCAOB adopted standards for auditors to use when assessing whether managers of a public company have accurately reported on the company's internal controls. These audit standards drive the work performed by the auditor, as well as the company, and benefit the examiner in their risk assessment of the company. Documentation should be included in the public company's external audit workpapers to support the requirements of SOX and the PCAOB. Examiners should plan to utilize this information and seek this documentation when reviewing external audit workpapers. The following section outlines the key areas of documentation that will be of assistance to the examiner.

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PHASE 4 – DETERMINE RESIDUAL RISK

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Financial Reporting Risk:

Financial reporting residual risk is the risk remaining after taking into account the controls established to achieve certain objectives in the financial reporting function or process. This residual risk may be the result of:

- A control deficiency, which exists when the design or operation of a control does not allow management or employees, in the normal course of performing their assigned functions, to prevent or detect misstatements on a timely basis.
- A significant deficiency, which 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.
- A material weakness, which is a deficiency, or a combination of deficiencies, in internal control, such that there is a reasonable possibility that a material misstatement of the company's financial statements will not be prevented, or detected and corrected on a timely basis.

Determining residual risk is the key to determining where the risks lie in an insurer's business. Once the riskier activities are identified, the examiner will use these results as the foundation to determine the extent and nature of testing in Phase 5.

Residual Risk Assessment Ratings

The overall residual risk assessment ratings should be documented as ~~are~~ High, Moderate, ~~and~~ or Low. ~~and should be documented in the Risk Assessment Matrix.~~

High Residual Risk – This risk rating generally would be assigned to an activity where the risk management process does not significantly mitigate the high inherent risk of the activity. Thus, the activity could potentially result in a financial loss that would have a significant adverse impact on the organization's overall condition, even in some cases where the processes are considered strong. For financial reporting risk, the existence of control deficiencies and/or material weaknesses could indicate a high residual risk. However, the lack of control deficiencies and/or material weaknesses does not exclude a residual risk determination of high. In cases where management appears to have an insufficient understanding of the risk and/or capacity (lack of timely and accurate information or analysis) to anticipate and respond to changing conditions, the examiner may need to re-evaluate their determination of the inherent risk and the residual risk.

Moderate Residual Risk – This risk rating generally would be assigned to an activity having moderate inherent risk where the risk management processes do not appropriately mitigate the risk. However, a strong risk management process may reduce the risks of an inherently high-risk activity so that any potential financial loss from the activity would have only a moderate, short-term, adverse impact on the financial condition of the organization. For financial reporting risk, this could be evidenced, in part, by the existence of control deficiencies, which are typically not considered to be significant or material weaknesses. In cases where management appears to have an insufficient understanding of the risk and/or capacity (lack of timely and accurate information or analysis) to anticipate and respond to changing conditions, the examiner may need to re-evaluate their determination of the inherent risk and the residual risk.

Low Residual Risk – This risk rating generally would be assigned to an activity that has low inherent risks. An activity with moderate inherent risk may be assessed as low residual risk where internal controls and risk management processes are strong and effectively mitigate much of the risk. After considering risk management controls, any potential financial loss from the activity would have minimal impact on the financial strength of the organization. For financial reporting, this could be evidenced, in part, by few or no control deficiencies.

Illustration of the Calculated Residual Risk Assessment

The following calculation should be used as a guide to determine calculated residual risk using the already determined assessments of inherent risk and risk controls. The Residual Risk Calculation is laid out left to right in a linear fashion. An examiner starts with the column on the left by identifying the level of assessed inherent risk as determined in Phase 2 (high, moderate, or low). Next, the examiner identifies the strength of risk controls as determined in Phase 3 (strong, moderate, or weak). The point where the inherent risk assessment and strength of risk controls intersect, results in the calculated residual risk. For example, if inherent risk was assessed as low and risk controls were assessed as strong, then the residual risk would be low. The calculated residual risk is recorded in the r~~R~~isk a~~A~~ssessment ~~Matrix~~ and utilized to design appropriate examination procedures in Phase 5. This calculation is not intended to force artificial limitations on the examiner and does permit the examiner to utilize professional judgment and experience with the insurer in determining whether the calculated residual risk is appropriate. The examiner is able to record a different level of residual risk (judgmental residual risk) in the r~~R~~isk ~~A~~assessment ~~Matrix~~ from what is calculated below and use that assessment when designing examination procedures.

Control Assessment

Inherent Risk Assessment		Strong Risk Controls	Moderate Risk Controls	Weak Risk Controls
	High	Moderate or High	Moderate or High	High
	Moderate	Low or Moderate	Moderate	Moderate*
	Low	Low	Low	Low*

* If, based on an assessment of weak risk controls, the examiner feels that the residual risk assessment should be higher than the calculated result; the examiner should consider revising the initial assessment of inherent risk and then recalculating residual risk.

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PHASE 5 – ESTABLISH/CONDUCT DETAIL EXAMINATION PROCEDURES

This section of the Handbook addresses the following subjects:

A. Establish/Conduct Detail Examination Procedures
B. Risks Other Than Financial Reporting
C. Financial Reporting Risks
D. Examination Considerations
E. Analytical Review Procedures as Substantive Tests

A. Establish/Conduct Detail Examination Procedures

The r~~R~~isk a~~A~~ssessment process ~~documentation, whether maintained in the Risk Assessment Matrix (Exhibit K), TeamMate+, or another format,Matrix (Exhibit K) is intended to be an all-encompassing documentation tool~~ should incorporate~~ing~~ the risk ~~assessment~~identification, control assessment, examination procedures and results. At the beginning of Phase 5, the r~~R~~isk a~~A~~ssessment process ~~Matrix (or similar documentation)~~ has been completed for each identified risk up to the residual risk ~~section~~assessment. ~~from left to right up to the residual risk assessment column for each risk identified.~~ At this juncture, after completion of the risk assessment ~~matrix~~ for each risk identified, the nature and extent of testing can be determined and the examination procedures designed accordingly. Examination procedures selected from those procedures set forth in this Handbook, as well as any other procedures warranted for a particular examination, may be imported into the relevant section of the r~~R~~isk a~~A~~ssessment documentation~~Matrix (or similar documentation)~~. ~~It is also acceptable to document the examination procedures performed in a separate workpaper and to provide a workpaper reference in the appropriate section of the Risk Assessment Matrix (or similar documentation).~~ Prior to the performance of Phase 5 test work, planned detail examination procedures should be approved and signed-off on by the chief examiner (or designee) and the examiner-in-charge. Results of the completed examination procedures and, where applicable, the disposition of the ~~certain~~ results (i.e., finding and errors), should be documented in the r~~R~~isk a~~A~~ssessment ~~Matrix (or similar documentation)~~. As discussed in Phase 4, there are three levels of residual risk: high, moderate and low. The following chart indicates the type and amount of testing necessary at each level:

High Residual Risk	Detail procedures required.
Moderate Residual Risk	Fewer detail procedures performed (i.e., tests of details of transactions), including more utilization of analytical procedures.
Low Residual Risk	Limited or no detail procedures performed, which may be limited to analytical procedures.

Although test work in Phase 5 is generally not required for low residual risks, there are certain situations where some detail tests are necessary to address such risks. For instance, if an examiner deems a low inherent risk to be significant enough to include ~~on~~in the risk ~~matrix~~assessment in Phase 2 and either does not perform control testing or assesses controls as weak in Phase 3, a minimum amount of detail testing should be performed (e.g., analytic procedures) in Phase 5.

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EXAMINATION REPOSITORY – CAPITAL AND SURPLUS

Own Risk and Solvency Assessment (ORSA)

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

Annual Statement Blank Line Items

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

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

Relevant Statements of Statutory Accounting Principles (SSAPs)

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

No. 41 — Surplus Notes
No. 72 — Surplus and Quasi-reorganizations

† Risks identified with this symbol may warrant additional procedures or consideration at the head of the internationally active insurance group (IAIG) or level at which the group manages its aggregated risks. Where IAIGs have a decentralized business model, at least in regard to certain operations and management of related risks, examiners should consider evaluating those risks at the subgroup or legal entity level. Refer to Section 1, Part I for additional guidance for examinations of IAIGs.

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EXHIBIT A

EXAMINATION PLANNING PROCEDURES CHECKLIST

COMPANY NAME ____

PERIOD OF EXAMINATION ____

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

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Part 5: Consideration of Prospective Risk Indications of Solvency Concerns		
1. Based on the preliminary analytical review, input from the analyst and the knowledge and understanding of the company, identify prospective risks that may indicate potential future solvency concerns for the company.		
2. Determine where the prospective risks identified will be addressed. For broad prospective risks that impact more than one key functional activity, post the risks to Exhibit V – Overarching Prospective Risk Assessment for review. For risks that are directly associated with a particular key activity, ~~post the risk to~~include them in that activity's risk ~~matrix~~ assessment for review.		
Phase 2 – Identify and Assess Inherent Risk in Activities		
1. Identify and assess inherent risks for key activities ~~using a~~within the risk assessment. ~~matrix or similar tool.~~ Consider both financial reporting risks and other than financial reporting risks in this process.		
2. Ensure that each inherent risk identified should be associated with at least one of the nine branded risk classifications identified in Exhibit L – Branded Risk Classification.		
3. Complete Exhibit CC – Issue/Risk Tracking Template by verifying that each item has been linked to a risk statement ~~on a key activity~~within the ~~matrix~~ risk assessment or Exhibit V – Overarching Prospective Risk Assessment or by documenting that additional work is not deemed necessary.		
4. Complete Exhibit DD – Critical Risk Categories to determine whether all relevant critical risk categories have been included/considered ~~on~~ in a risk ~~matrix~~assessment. In situations where a particular critical risk category is not addressed by at least one risk statement, the exam team should explain, in the planning memorandum, the rationale for why a critical risk category is not considered applicable to the company under exam.		

5. Complete the planning process, including Exhibit I – Examination Planning Memorandum.		
6. Obtain the chief examiner's or designee's approval of planning documentation, including Exhibit I – Examination Planning Memorandum, before control and detail test work is performed.		

EXHIBIT E

AUDIT REVIEW PROCEDURES

COMPANY NAME ____

PERIOD OF EXAMINATION______________________________________

EXAMINATION FIELD DATE_____________________________________

PREPARED BY____

DATE____

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AUDIT REVIEW PROCEDURES

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8. Obtain from the external auditor a complete copy of all relevant workpapers, including work performed at the parent or holding company level, in accordance with Section 13 of the NAIC *Annual Financial Reporting Model Regulation*.

Guidance Point: **The high-level general review of the workpapers is to assess the competency and approach of the external auditor and determine what work is available and conducted in a manner that will allow reliance by the examiner. The examiner will perform a detailed review on any workpapers related to specific control or substantive test work that may be relied upon to address specific risks identified for ~~matrix~~ risk assessment review during Phase 3 and Phase 5.**

a. Review at a high-level the workpaper index and workpapers to identify any material financial statement accounts to determine if they were appropriately reviewed by the external auditor. Consider the impact the auditor's work will have on the identification of risks necessary for assessment by the examiner.

Guidance Point: **Accounts that were not reviewed by the external auditor may correspond to the auditor's completed risk assessment and methodology. The examiner should not default to the same risk assessment as the auditor without evaluating the adequacy of the auditor's rationale.**

EXHIBIT G

CONSIDERATION OF FRAUD

COMPANY NAME____

PERIOD OF EXAMINATION____

EXAMINER-IN-CHARGE____

In accordance with the Risk-Focused examination approach, the consideration of fraud in financial condition examinations should occur throughout all phases of the examination, primarily through the identification and examination of fraud risk factors. Fraud risk factors are conditions that may indicate the occurrence of fraud, such as the insufficient review of controls, failure to respond to known accounting irregularities, extraordinary growth or profitability, threat of regulatory action, and missing accounting documentation.

In the planning phase of the examination, it is important that the exam team include a discussion of fraud in the planning meeting that takes place with the financial analyst. The analyst's review of unusual fluctuations, performance outside of the industry average, etc., can help the examiner understand the tone of the organization as a whole and identify areas that may need to be investigated further during the examination.

It is also vital that the examiner gains an understanding of the fraud assessment and procedures already completed by the external auditor and the level at which they were completed; i.e., holding company or legal entity level. The external auditors are required by AU Sec. 316—*Consideration of Fraud in a Financial Statement Audit* to perform specific procedures to ensure that the audit has been responsibly planned and performed and to obtain reasonable assurance that the financial statements are free of material misstatement. In accordance with guidance from the American Institute of Certified Public Accountants (AICPA), documentation of the auditor's consideration of fraud should be included in the external audit workpapers, which examiners review within Exhibit E – Audit Review Procedures. The examiner should utilize the external audit workpaper documentation to the fullest extent deemed reasonable if the auditor's risk assessment is at the appropriate level. However, reliance on the external audit workpapers does not preclude the examiner from identifying and inquiring about fraud risk factors noted during the examination or interviewing company management regarding the possibility of fraud or known fraud occurrences.

Parts 1-3 of this exhibit should be completed regardless of the level of reliance on the external auditor. If the examiner determines that the external audit fraud assessment and/or related procedures are not sufficient, complete, or at the correct level, they should also utilize Part 4, "Review Company Operations and Identify Fraud Risk Factors." It may also be beneficial to ~~utilize the Key Activity Risk Assessments Matrix (Exhibit K) to~~ identify and assess inherent risks, assess controls, determine residual risks, and identify test procedures within the risk assessment process for applicable fraud risk factors.

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EXHIBIT I

EXAMINATION PLANNING MEMORANDUM

The following is an illustration of an examination planning memorandum to assist examiners in documenting the results of the planning process at the conclusion of Phase 2. This exhibit is not intended to be all-inclusive and should be tailored to each examination. It is not necessary for every examination's planning memorandum to address each of the 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 pertinent information considered. In making these judgments, the examiner should bear in mind the purpose of the planning memorandum, which is to provide a concise summary of examination risks, significant examination activities and the overall examination approach. Where feasible, the planning memorandum should reference key documents, detail reports and information through attachment. Some items that may be attached to the planning memorandum are the preliminary analytical review, annual statement jurat page, Schedule Y and FEETS Premium Schedule.

COMPANY NAME:

EXAMINATION DATE:

This planning memorandum is intended to document our examination plan as it relates to (Name of Insurance Company) for the period from January 1, 20XX to December 31, 20XX.

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CORPORATE GOVERNANCE (Phase 1, Part 2)

Examinations using the risk-focused examination approach promote the assessment of risk management processes other than those that result in financial statement line item verifications—including Board of Directors' effectiveness and corporate governance activities—thus providing a prospective look at the operations and quality of the risk management process. Consideration of the aforementioned factors should be given during the planning phase of an examination, as they relate directly to the company's control environment. Examiners should summarize the overall corporate governance assessment after completing a review as outlined in Exhibit M – Understanding the Corporate Governance Structure.

A specific corporate governance memorandum may be referenced that provides additional information, such as a listing of individuals (with titles) and separate assessments of management and the Board of Directors. This memo should identify the examiners' assessment of management in terms of experience of senior staff, past performance, management approach (i.e., aggressive/conservative accounting or sales practices), recent changes or turnover, overly aggressive compensation or bonus structure, appropriate reporting channels, etc.

Interview Results

This section should document risks, both financial reporting and other than financial reporting, that are identified by the exam team as a result of conducting interviews with company personnel. The examiner can then document whether each risk should be included in a key activity risk ~~matrix~~ assessment or documented using Exhibit V – Overarching Prospective Risk Assessment.

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EXHIBIT L

BRANDED RISK CLASSIFICATIONS

In order to assist examiners in categorizing identified risks, this exhibit links common risk areas and risk management controls to the branded risk classifications. This exhibit has been provided as a guide to the examiner and does not represent an all-inclusive list of risk areas or risk management controls that will be identified when obtaining an understanding of the insurer's operations. In addition, it should not be considered ~~to be~~ an exhaustive or definitive guide in determining the type of branded risk classification that would apply to each risk area, as each situation must be considered individually in the context of the insurer's environment in order to determine the appropriate branded risk classification. The nine branded risk classifications are to be identified in the ~~R~~risk ~~A~~assessment ~~Matrix~~ for each key activity being examined. More than one of the nine branded risk ~~types~~ classifications may be applicable to a particular identified risk~~risk within a key activity; as such, more than one risk type may be listed in the Risk Assessment Matrix.~~. The following guidance is designed to help examiners think critically about the correlation between the nine branded risk classifications and various areas of the financial statements.

1. **Credit Risk – Amounts actually collected or collectible are less than those contractually due or payments are not remitted on a timely basis.**

   Risk Areas to Consider:

   - Level and trend of non-investment grade, problem, restructured, delinquent and non-performing earning assets.
   - Existence of asset concentrations to include reinsurance recoverables and/or intercompany receivables.
   - Strength of affiliates involved in reinsurance pooling or asset participation arrangements.
   - Custodial arrangements.
   - Materiality of agents' balances.
   - Use of derivative or off-balance sheet transactions to mitigate credit risk (counter-party risk).
   - Premium and other receivables (e.g., commissions, refunds, etc.).

   Evaluating Credit Risk Management Controls (i.e., Effectiveness):

   - Policies established by management and the board are comprehensive and define risk tolerances, asset allocations and accountabilities.
   - Underwriting standards and risk identification processes are in place, and audited for compliance.
   - Exceptions (particularly management overrides) to policies and/or processes are reported to the board.
   - Through utilization of risk monitoring processes, problem assets (including agents' balances and affiliate receivables) are identified timely and collection steps initiated quickly.
   - Custodial arrangements are reviewed periodically and compliance with investment laws and regulations is monitored and reported to management and the board.
   - Reinsurers are evaluated regularly for financial strength.
   - Information systems are accurate, dependable and validated.

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EXHIBIT M

UNDERSTANDING THE CORPORATE GOVERNANCE STRUCTURE

Overview

The purpose of this exhibit is to assist the examiner in documenting the understanding and assessment of an insurer's corporate governance policies and practices, including its ERM function. As insurers are expected to demonstrate different corporate governance practices in accordance with the nature and extent of their operations, examiners should not expect the practices of each individual insurer to specifically match the guidance provided in this exhibit. Therefore, the focus of an examination team's considerations in this area should be to determine whether the practices implemented by the insurer are reasonable and effective.

The examination team should first attempt to utilize information obtained through Exhibit B – Examination Planning Questionnaire, Exhibit Y – Examination Interviews and other planning sources (including information provided to the financial analyst and any other information available to the examiner) before requesting any additional information that may be necessary to gain an understanding and perform an assessment of corporate governance. A favorable overall assessment of governance does not, by itself, serve to reduce the scope or extent of examination procedures; rather, specific governance controls need to be assessed for their adequacy of the management of specific risks, in conjunction with other controls designed to manage the same.

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G. DOCUMENTATION

The examination team should document its understanding and assessment of the entity's governance, as well as its assessment on the related impact on the examination. This summary should include a description of any unique examination procedures, including special inquiries that are considered necessary to any significant risks identified as a result of the assessment.

~~The Risk Assessment Matrixdocumentation, as the central documentation toolsuch as the Risk Assessment Matrix, should be utilized for the ~~I~~i~~dentification and assessment of individual solvency risks requiring review should be documented through the risk assessment process. However, documentation on the understanding and assessment of corporate governance is at the discretion of the examiner and would not typically be presented in a risk assessment~~ documentation.~~ ~~a Risk Assessment Matrix~~. For most companies, a memorandum and/or corresponding documentation in the electronic workpapers addressing the items presented in this exhibit should provide sufficient documentation. For example, the documentation could summarize the attributes and techniques supporting the examiner's overall evaluation, any resulting examination scope implications, and the approach used to validate the more significant attributes and techniques. For smaller companies, documentation of the examination's consideration of corporate governance may be provided in the appropriate section of Exhibit I – Examination Planning Memorandum.

Specific findings or concerns related to an insurer's corporate governance practices should be accumulated for inclusion in a management letter (or similar document) to provide feedback and recommendations to the insurer. In addition, the examination should utilize Exhibit AA – Summary Review Memorandum (or a similar document) to summarize its understanding and assessment of the insurer's overall corporate governance framework, as well as the maturity and reliability of its ERM function, to ensure appropriate communication back to the financial analyst.

EXHIBIT Q

REVIEW AND APPROVAL SUMMARY (RAS) FOR EXAMINATIONS

NAME OF COMPANY ______________________________

EXAMINATION DATE ______________________________

EXAMINER-IN-CHARGE ______________________________

SUPERVISING EXAMINER ______________________________

	Performed By	Date
Detailed Review *(usually performed by the examiner-in-charge)*		
1. I have read the Examination Planning Memorandum, risk ~~matrices~~assessments, and examination program insofar as they relate to the areas of the examination I reviewed.		
2. I have reviewed all workpapers and I am satisfied that the planned procedures were performed, results of work were adequately documented, and procedures performed were sufficient considering the results obtained and any changes in conditions occurring since the procedures were planned.		
3. I have verified that all known significant solvency risks have been addressed and each critical risk category has been appropriately considered.		
4. I have compared the accounts in the general ledger trial balance or examination workpapers with the summarizations, classifications, and descriptions of them in the annual financial statement.		
5. I am satisfied that the examination was conducted in accordance with appropriate professional standards, department policies and the procedures set forth in the *Financial Condition Examiners Handbook*.		
6. I have documented the results of the on-site examination and shared them with the assigned analyst. (Results may be documented through the use of Exhibit AA – Summary Review Memorandum (SRM). The SRM should include discussion of potential ongoing or future solvency concerns the insurer may face, the insurer's corporate governance and a summary, by branded risk classification, of examination adjustments, other examination findings, management letter comments and other residual risks or concerns the examiner may want to communicate to department personnel.)		
7. I have collaborated with the analyst in developing the prioritization level and supervisory plan.		

General Review (*usually performed by the chief examiner or designee)*		
1. I have reviewed the Examination Planning Memorandum, risk ~~matrices~~ assessments and examination program.		
2. I have reviewed the workpapers for this examination and I am satisfied that the planned procedures were performed, results of work were adequately documented, procedures performed were sufficient, each known significant solvency risk was addressed and each critical risk category was appropriately considered.		
3. I am satisfied that the examination was conducted in accordance with appropriate professional standards, department policies and the procedures set forth in the Financial Condition Examiners Handbook.		
4. I have reviewed the documented results of the examination that were shared with the assigned analyst, and I am satisfied that the examination results were adequately communicated.		
5. I have reviewed the prioritization level and supervisory plan prepared or updated at the conclusion of the examination and concur with the results.		
6. I have reviewed the Report of Examination, and I am satisfied that it was prepared in conformity with statutory accounting principles as prescribed in the *Accounting Practices and Procedures Manual* or as permitted by the department.		

Note: Completion of procedures should be indicated by dating and initialing the space provided. Any exceptions (e.g., Not Applicable) should be explained either in this RAS or in an attached memorandum.

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. 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 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.

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~~ assessment 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, or relates to more than one key activity), the examiner should utilize this exhibit to document the investigation of the overarching prospective risks. Individual risks should either be addressed on Exhibit V or in a key activity ~~matrix~~risk assessment, 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.

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 investigation 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:

Template Column	Instructions for Completing
Overarching Prospective Risk Identified	Based on the knowledge and understanding of the company obtained during the planning stages of the exam, document any overarching prospective risks identified.
Branded Risk Classification	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).
Risk Mitigation Strategies	Identify risk mitigation strategies in place at the insurer (if any) to address the prospective risk.
Investigate Risk Exposure	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.
Risk Assessment Level	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.
Trend	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.
Rationale	Document the rationale for the trend and level of concern.
Communicate Findings to Financial Analysis	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.

Exhibit V, Part Two – Common Areas of Concern

Exhibit V, Part Two may be used 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

Overarching Prospective Risk Identified	Branded Risk	Risk Mitigation Strategies	Investigate Risk Exposure	Risk Assessment Level	Trend	Rationale	Communicate Findings to Financial Analysis
Example Prospective Risk 1: *The company may experience rating agency downgrades, causing the company to be unable to sell its products.*	*ST* *RP*	*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.*	*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: Financial Reports~~(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*	*Moderate*	*Static*	*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.*	*If a future rating downgrade occurs the DOI should meet to determine an appropriate course of action (e.g., limited scope exam).*

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Overarching Prospective Risk Identified	Branded Risk	Risk Mitigation Strategies	Investigate Risk Exposure	Risk Assessment Level	Trend	Rationale	Communicate Findings to Financial Analysis
			of the calculated amount. See Capital Calculation ~~A.1.5~~ for more information.				
Example Prospective Risk 2: *Mergers, acquisitions and business divestitures are not successfully executed, resulting in excessive cost and/or regulatory concerns.*	*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 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.*	*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.* *Reviewed minutes from the 20XX annual Board of Directors meeting, noting that the mergers & acquisitions process was reviewed and approved by the Board of Directors and Management. ~~(See wp~~*	*Moderate*	*Increasing*	*Although the company is actively involved with merger and acquisition activities, the exam team verified that this activity is part of its strategic plan and that an effective due diligence process is in place. However, given the significance of the last transaction and the stage of implementat*	*The exam team is comfortable with the Company's abilities with regard to mergers and acquisitions. However, if the analyst identifies changes to the Company's strategic business plan, the DOI should meet to discuss whether the changes warrant action before the next examination date.*

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Overarching Prospective Risk Identified	Branded Risk	Risk Mitigation Strategies	Investigate Risk Exposure	Risk Assessment Level	Trend	Rationale	Communicate Findings to Financial Analysis
			~~*B.2.2)*~~*See: Company BOD Minutes* *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&A policy was followed.* ~~*(see additional detail regarding documents reviewed at B.2.PRG)*~~ *Reviewed minutes from Q1 and Q3 M&A steering committee meetings and verified that financial details regarding the*			*ion, trend is rated as increasing.*	

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Overarching Prospective Risk Identified	Branded Risk	Risk Mitigation Strategies	Investigate Risk Exposure	Risk Assessment Level	Trend	Rationale	Communicate Findings to Financial Analysis
			anticipated acquisition of FLH insurance company were discussed. See: M&A Steering Committee Minutes~~(see wps B.2.3 and B.2.4).~~				
Example Prospective Risk 3: *The company is developing new products and may experience issues in pricing, underwriting, and reserving*	*PR/UW*	*Company analysts perform 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.*	*Reviewed the monthly 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).~~See Market Conditions Report* *Reviewed the qualifications and background of the employees*	*Minimal*	*Static*	*The company has a verified history of successful product launches and its process for considering and launching products going forward is fully vetted throughout the company.*	*The analyst will be asked to monitor financial ratios related to new lines of business and report any significant deviations to the exam unit.*

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Overarching Prospective Risk Identified	Branded Risk	Risk Mitigation Strategies	Investigate Risk Exposure	Risk Assessment Level	Trend	Rationale	Communicate Findings to Financial Analysis
		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	*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: Employee*				

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Overarching Prospective Risk Identified	Branded Risk	Risk Mitigation Strategies	Investigate Risk Exposure	Risk Assessment Level	Trend	Rationale	Communicate Findings to Financial Analysis
			Qualifications ~~*(see A.2.3).*~~ *Obtained meeting 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* *See:* *Company BOD Minutes* ~~*(A.2.5).*~~				
Example Prospective Risk 4: *The company may experience*	*ST PR/UW*	*As the company underwrites primarily in hurricane-prone geographies, it runs both short- and medium-term climate scenarios that include additional frequency and severity of hurricanes to*	*Obtained the insurer's ORSA and details of the climate scenarios used to stress the underwriting*	*Moderate*	*Increasing*	*Increase in frequency and/or severity of natural hazards due to climate*	*The analyst should review the ORSA summary report to understand how the company*

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Overarching Prospective Risk Identified	Branded Risk	Risk Mitigation Strategies	Investigate Risk Exposure	Risk Assessment Level	Trend	Rationale	Communicate Findings to Financial Analysis
increased frequency and/or increased severity of natural hazards due to climate change risk in future years, affecting its ability to achieve its long-term business strategy. *Note: Only P/C insurers.*		*estimate their potential impacts. The results of the short-term scenarios are presented in the ORSA report. The medium-term scenarios are projected over a 5-to-10-year event horizon and indicate a potentially significant increase in loss costs that would require changes to the underwriting/reinsurance strategy or require additional capital. The company is currently evaluating the impact on its long-term business strategy and plans to present recommendations to its board of directors at the next annual meeting.*	*results and the capital in section III of the ORSA.* *See: ORSA Summary Report~~(Refer to A.1.2)~~* *Reviewed the results of medium-term climate stress scenarios noting material increases in loss costs for hurricane events across the various scenarios ~~(Refer to A.2.3.)~~*			*change risk may reduce underwriting profit and may create a need for additional capital. However, the company runs climate scenarios to simulate the underwriting and capital impact of climate change*	*manages the short-term impacts of climate change risks through the use of climate scenarios quantifying the impact to underwriting, reinsurance, and capital.* *The analyst should request a copy of recommendations for the board of directors on the impact of climate scenarios on the company's long-term business strategy. In addition, the analyst should request updated medium-term climate scenario results from the company annually to track*

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Overarching Prospective Risk Identified	Branded Risk	Risk Mitigation Strategies	Investigate Risk Exposure	Risk Assessment Level	Trend	Rationale	Communicate Findings to Financial Analysis
							changes in estimated future exposures.
Example Prospective Risk #5: *The company's executive compensation plans include incentives based on financial metrics that may encourage riskier decision-making.*	*OP*	*The Board of Directors reviews and approves executive compensation plans, including any incentive plans. Incentive plans and variable compensation practices are intended to emphasize long-term financial goals and avoid excessive focus on short-term growth and performance.* *The Company pays out incentive compensation based on the achievement of performance goals and maintains a claw back policy that allows the Company to recover incentive compensation in the event that financial statements must be restated.*	*Obtained the board minutes to ensure board review and approval of the executive compensation plan structure, which incorporates some long-term goals. However, much of the incentive compensation continues to be based on short-term growth and performance goals ~~(Refer to A.4.2).~~See: Company BOD Minutes* *Obtained and reviewed detailed support for incentive payment calculations,*	*Moderate*	*Increasing*	*The Company's executive compensation plan has been reviewed and approved by the Board; however, the incentives are largely dependent upon some metrics (i.e., annual premium growth) that have the potential to encourage excessive risk-taking by executives.*	*The analyst should continue to monitor fluctuations in the company's general expenses, as well as the overall expense ratio and profitability to identify potential issues regarding the executive compensation structure.* *Review the Corporate Governance Annual Disclosure (CGAD) for information referring to the executive compensation practices and follow up on any*

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Overarching Prospective Risk Identified	Branded Risk	Risk Mitigation Strategies	Investigate Risk Exposure	Risk Assessment Level	Trend	Rationale	Communicate Findings to Financial Analysis
			verifying the accuracy of calculations in accordance with the written plan. Also reviewed and verified the Company's claw back policy. *See: Incentive Payment Calculations* ~~*(Refer to A.4.5).*~~				*changes identified.*

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EXHIBIT CC

ISSUE/RISK TRACKING TEMPLATE

The primary goal in Phase 1 of the examination is to gain an understanding of the company being examined to enable the critical risks facing an insurer to be identified. Issues and risks can be identified from numerous sources, including the interview process, communication with analysts, a review of corporate governance information, a review of information available through the internal and external audit functions, a review of IT functions and documentation, and other assessments completed as part of Phase 1.

Exhibit CC is intended to house significant issues and risks identified during Phase 1 to ensure that they are appropriately addressed and/or considered during the examination. Examiners should use the template below, or a substantially similar document, to track the issues and risks identified, which include prospective risks. However, examiners are not expected to utilize this template to identify each and every risk that will be included ~~on~~ in a key activity ~~matrix~~risk assessment. Instead, this template should be utilized to identify risks that could include those unique to the insurer, specific to a particular line of business/company activity or of heightened importance as determined through gaining an understanding of the company.

When using this template, the examiner should document the issue or risk identified and its source(s). If an issue or risk has multiple sources, the examiner need only list the issue or risk once on the template and should document all significant sources from which it was identified in the adjacent box. In addition, the examiner should include the area where the issue or risk is addressed (e.g., ~~on~~ in a key activity risk assessment~~matrix~~, on Exhibit V, etc.) and any additional information deemed necessary. Alternately, after further review, the examiner may determine that no follow-up is necessary for an issue or risk identified; in those instances, the examiner should document this conclusion on the template.

Instructions for completing and documenting the issues or risks identified within the template are as follows:

Template Column	Instructions for Completing
Issue/Risk Identified	Based on the knowledge and understanding of the company obtained during Phase 1 of the examination, document the issue/risk identified, including prospective risks.
Source(s) of Issue/Risk	Identify the source(s) of the issue/risk. Examples include but are not limited to: communication from the financial analyst, communication from other regulators (other states, federal, international, etc.), A.M. Best reports, AICPA audit alerts, review of regulatory filings, C-level interviews, review of minutes, department planning meeting notes, market conduct reports, company risk assessments, etc.
Where Addressed	Provide a reference to where the issue/risk is addressed, such as a key activity ~~matrix~~risk assessment, Exhibit V, or other areas within the examination file.
Additional Information	If no follow-up is necessary for an issue or risk identified, briefly document this conclusion and/or provide any additional information deemed necessary to further clarify the issue/risk.

Example risks have been included below to demonstrate the level of documentation expected to be included in a tracking template.

Issue/Risk Tracking Template

Issue/Risk Identified	Source(s) of Issue/Risk	Where Addressed	Additional Information
Example 1 – Company plans to begin writing a new line of business next year.	*Issue referred from rates and forms unit (See: Step 2 – Obtain Existing Documentation~~A.1.6~~) and brought up in C-Level interviews (See: Step 1 – Conduct Interviews~~A.3.5, A.3.7~~).*	*See Exhibit V (Risk 3).*	*N/A*
Example 2 – The percentage of the company's invested assets held in equities has increased significantly over the past two years.	*Issue referred by the financial analyst (See: Step 1 – Meet with the Financial Analyst~~)see A.1.5~~) and discussed in the department planning meeting (~~see A.1.12~~See: Step 7 – Meet With Chief Examiner).*	*See risk 1.1 on the Investment Risk ~~Matrix~~ Assessment (See: Investments Risk Assessment~~C.2.3~~).*	*N/A*
Example 3 – The company's expense ratio is significantly higher than the industry average.	*Issue noted during examiner's review of the AM Best report* ~~(see A.1.7~~AM Best Report Review~~).~~	*Not deemed necessary.*	*After further discussion, it was noted that the company's historical expense ratios are higher than the industry average due to the unique coverage written by the company. As ratios have been relatively flat and the company remains profitable, no additional review is deemed necessary.*
Example 4 – The company has service agreements with affiliates that may have a material impact on the insurer.	*Issue noted during a planning meeting with the analyst.*	*See risk 1.1 on the Related Party ~~Matrix~~ Assessment (See: Related Party Risk Assessment~~C.3.3~~).*	*N/A*

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EXHIBIT DD

CRITICAL RISK CATEGORIES

One of the goals of a risk-focused examination is to focus on the most critical financial solvency risks facing an insurer. To assist the examination team in meeting this goal, a list of critical risk categories has been developed for consideration in reviewing the adequacy of risk statements developed for each examination. The initial identification of risks in Phase 2 should utilize the understanding of the company gained in Phase 1, as well as a consideration of branded risk classifications, exam assertions, etc. The critical risk categories can then be used at the end of Phase 2 to ensure that the risks identified through this process cover some of the most common solvency risks identified by insurance regulators. The expectation is that each critical risk category will be addressed by at least one risk statement ~~on~~ in a key activity risk assessment~~matrix~~ (or Exhibit V). Alternatively, if the exam team determines that a particular category is not applicable or critical to the company being examined (i.e., the company does not have exposure in the category), an explanation may be provided within the Examination Planning Memorandum.

The critical risk categories take into consideration both financial reporting and other than financial reporting risks, which categories would be common to most insurers and the typical impact of a risk category on the current and prospective financial solvency of an insurer. Specific risk statements that are used to address the critical risk category investigation requirement should be tailored based on the company's risk profile, which may necessitate consideration of matters such as climate change, terrorism, a pandemic, cybersecurity, etc. Additional risks beyond the critical risk categories are expected to be identified and reviewed through the examination process at the discretion of each examination team as described in Section 2 of this Handbook.

To demonstrate that the examination has covered each of the relevant critical risk categories, the template below should be completed to demonstrate where in the exam file each critical risk area is addressed. This may be accomplished by providing reference to each individual risk statement that addresses each critical risk category. In situations where a particular critical risk category is not addressed by at least one risk statement, the exam team should provide reference to an explanation provided within the Examination Planning Memorandum.

Critical Risk Category Reporting Template

Risk Category	Description	Where Addressed
Valuation/ Impairment of Complex or Subjectively Valued Invested Assets	This category encompasses the valuation of particularly complex or subjectively valued investment holdings significant to the insurer, including assets that are hard-to-value, high-risk and/or subject to significant price variation, with a focus on current valuation. The likelihood of security impairment and determination of whether those impairments are other than temporary would also be an area to consider.	*Example Comment: See Risk 2.1 and Risk 3.1 ~~on~~ in the ▣ 🗎 Investments Risk Assessment~~Matrix~~.*
Liquidity Considerations	This category encompasses the ability of the insurance company to meet current contractual obligations, which could include liquidating assets or obtaining adequate funding without incurring unacceptable losses. This category is most relevant for near-term cash flow needs that could impact the insurer (one to two years).	*Example Comment: This critical risk category was not deemed relevant. See a discussion in the ▣ 🗎 Examination Planning Memorandum~~EPM at A.5.3~~.*

Risk Category	Description	Where Addressed
Appropriateness of Investment Portfolio and Strategy	This category encompasses whether the insurer's investment portfolio and strategy are appropriately structured to support its ongoing business plan. Considerations may include elements of the ongoing investment strategy such as asset diversification, quality, maturities and risk/reward considerations, which could impact the insurer's vulnerability to future market fluctuations and impairments associated with various scenarios (e.g., real-estate downtown, a pandemic, significant shift in interest rates, climate change/energy transition, etc.). For long-term lines of business in particular, these considerations would address asset adequacy testing/liability matching.	*Example Comment: See Risk 5 and Risk 6 on Exhibit V.~~Exhibit V at A.7.3.~~*
Appropriateness/ Adequacy of Reinsurance Program	This category encompasses the overall reinsurance strategy of the insurer, whether the strategy is appropriate to support its ongoing business plan and whether adequate coverage is in place to address the insurer's risk exposures (e.g., catastrophe/climate risks, morbidity risk, etc.). Considerations may include the quality of reinsurance counterparties, types of coverage in place, associated limits, net retentions, concentration of reinsurance cessions, coverage periods, terms, affiliated agreements, etc.	
Reinsurance Reporting and Collectability	This category encompasses whether all reinsurance amounts are properly accounted for and reported by the insurer. Considerations may include the existence and valuation (including collectability) of reinsurance recoverable amounts and reserve credits. In addition, proper accounting and reporting/disclosure for risk transfer issues may be considered.	
Underwriting and Pricing Strategy/Quality	This category encompasses whether the insurer has appropriate underwriting, pricing and marketing practices (including premium management) to meet its financial solvency needs. Considerations may include whether the insurer has established and implemented appropriate risk exposure limits and underwriting guidelines, whether the insurer is establishing adequate rates for the risks assumed under its policies and expense structure, and whether these strategies and practices are consistently applied across the insurer's distribution channels to appropriately address exposure to a wide range of insurance risks (e.g., catastrophe/climate, pandemic, increased mortality/morbidity, etc.).	
Reserve Data	This category encompasses whether selected elements of the underlying data utilized by the actuary in reserve calculations are complete and accurate. Considerations may include claim or in-force data depending on the lines of business and reserving methodologies utilized by the insurer.	

*****Text Eliminated to Conserve Space*****

GLOSSARY

*****Text Eliminated to Conserve Space*****

Other than Financial Reporting Risk	Business or strategic risk that is inherent in the insurer's operations and that has either an immaterial impact or no impact on the current financial statements but may have a solvency impact in the future.
Overall Residual Risk	The extent of risk the examiner believes is retained within a specific identified risk after the consideration of risk-mitigation strategies/controls; also known as the final assessment of residual risk after considering both the calculated residual risk and judgmental residual risk.
ORSA	Acronym for Own Risk and Solvency Assessment which is a reporting requirement for insurers above a specified premium threshold and includes the insurer's assessment of its risk management framework, company risks and capital needs. See Section 1, Part XI.
Participating State	A state that does not lead, but participates in a group examination.
Planning Materiality (PM)	The examiner's judgment of materiality made during initial planning. It is used in developing the overall scope of the examination procedures.
Preventive Controls	Controls designed to prevent risks from occurring in a process.
Prioritization	Based on multiple applications (e.g., exam results, financial analysis), a qualitative and quantitative system of ranking insurers for the purpose of determining the nature and extent of solvency monitoring to be performed. For example, insurers with a higher priority may be examined more frequently and earlier in a particular cycle.
Professional Judgment	The ability and willingness to assess gathered information and make objective judgments on the basis of well-supported reasons. Also known as *Critical Thinking*.
Prospective Risk	The risk associated with whether an insurer's current condition or processes provide indications of future solvency concerns.
Review and Approval Summary	A form that documents the performance of review requirements by the examiner-in-charge and other supervisory examiners. See Exhibit Q.
Risk Assessment ~~Matrix~~Documentation	~~A tool developed to serve as the central location (lead sheet) for the d~~Documentation of risk assessment and testing conclusions, whether maintained in the Risk Assessment Matrix (Exhibit K), electronic workpaper application, or another format. ~~See Exhibit K.~~
Risk-Management Program	The procedures by which an insurer identifies, controls, monitors, evaluates and responds to its risks on an ongoing basis.
Risk-Mitigation Strategies	Procedures and policies that are utilized by insurers to mitigate inherent risk in key activities. This term is normally used when referring to Other than Financial Reporting risks. Generally, the term Internal Controls is used when referring to Financial Reporting risks.
Risk Statement	A statement associated with a key activity within the r~~R~~isk a~~A~~ssessment ~~Matrix~~ describing an inherent risk identified by an examiner. This statement considers the answer to the question, "What could go wrong?" and is stated negatively.
Risk-Based Capital (RBC)	The minimum capital requirement an insurer must maintain. The calculation of RBC results in various Action and Control levels for insurer ratio results that fall within a certain percentage range.
Risk-Focused Surveillance Approach	A process of identifying significant risks, assessing and analyzing those risks, documenting the results of the analysis, and developing recommendations for how the analysis can be applied to the ongoing monitoring of the insurer.
Sarbanes-Oxley Act of 2002	A federal act that requires the external auditor to attest to management's assertion of adequate financial reporting internal controls.

