Draft date: 9/11/2024

Virtual Meeting

FINANCIAL EXAMINERS HANDBOOK (E) TECHNICAL GROUP
Monday, September 23, 2024
2:00 – 3:00 p.m. ET / 1:00 – 2:00 p.m. CT / 12:00 – 1:00 p.m. MT / 11:00 a.m. – 12:00 p.m. PT

ROLL CALL

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

NAIC Support Staff: Bailey Henning/Elise Klebba

AGENDA

1. Consider Adoption of Handbook Guidance – *John Litweiler (WI)*
   a. Risk-Focused Surveillance (E) Working Group Referral and Revisions Related to Affiliated Investment Management Services and Agreements — Attachment 1

2. Consider Exposure of Handbook Guidance – *Eli Snowbarger (OK)*
   a. Revisions Related to Executive Compensation — Attachment 2
   b. Revisions Related to Modco Reinsurance — Attachment 3

3. Discuss Any Other Matters Brought Before the Technical Group – *John Litweiler (WI)*

4. Adjournment

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MEMORANDUM

TO: Eli Snowbarger (OK), Co-Chair, Financial Examiners Handbook (E) Technical Group
John Litweiler (WI), Co-Chair, Financial Examiners Handbook (E) Technical Group

FROM: Amy Malm, Chair, Risk-Focused Surveillance (E) Working Group

DATE: May 30, 2024

RE: Affiliated Services Guidance

In late 2022, the Risk-Focused Surveillance (E) Working Group received a referral from the Macroprudential (E) Working Group recommending updates to NAIC handbooks (Examiners and Financial Analysis) to provide more guidance to regulators on reviewing affiliated investment management services and agreements. The referral was part of a broader initiative to address a list of "Regulatory Considerations Applicable (But Not Exclusive) to Private Equity (PE) Owned Insurers." Because the issue was important for both financial analyst reviews of Form D filings and the subsequent review of affiliated investment services during financial exams, the topic was referred to the Risk-Focused Surveillance (E) Working Group so that guidance could be developed together for both functions.

After a development period that included drafting group work, presentation of the proposed guidance at an in-person meeting, public exposure, and a call to review and finalize an updated draft, the Risk-Focused Surveillance (E) Working Group finalized updated drafts of proposed revisions to the NAIC's *Financial Analysis Handbook* (FAH) and *Financial Condition Examiners Handbook* (FCEH). The proposed edits to the FCEH are provided in **Attachment One** of this memorandum.

As the proposed revisions have been thoroughly reviewed and subject to multiple public comment periods, we recommend they be considered by the Financial Examiners Handbook (E) Technical Group for adoption without additional public exposure or significant modifications, to ensure the guidance remains consistent with the revisions proposed for the FAH.

If there are any questions regarding the proposed recommendations, please contact us or NAIC staff (Bruce Jenson at *bjenson@naic.org*) for clarification. Thank you for your consideration.

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Attachment One

Note: This document includes excerpts from the NAIC's *Financial Condition Examiners Handbook* to which revisions are being proposed to update guidance around the review of affiliated investment management services and agreements. The proposed revisions are shown as tracked changes throughout.

Examination 1 – Section 1-III F. Outsourcing of Critical Functions

III. GENERAL EXAMINATION CONSIDERATIONS

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

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

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F. Outsourcing of Critical Functions

The examiner is faced with additional challenges when the insurer under examination outsources critical business functions to third parties. It is the responsibility of management to determine whether processes which have been outsourced are being effectively and efficiently performed and controlled. This oversight may be performed through a number of methods, including performing site visits to the third-party or through a review of Statement of Standards for Attestation Engagements (SSAE) 18 work that has been performed. In some cases, performance of site visits may even be mandated by state law. However, regardless of where the business process occurs or who performs it, the examination must conclude whether financial solvency risks to the insurer have been effectively mitigated. Therefore, if the insurer has failed to determine whether a significant outsourced business process is functioning appropriately, the examiner may have to perform testing of the outsourced functions to ensure that all material risks relating to the business process have been appropriately mitigated.

When conducting an examination of insurers that are part of a holding company group, including internationally active insurance groups (IAIGs), the exam team should evaluate whether appropriate due diligence has been performed prior to entering new material outsourcing agreements. The exam team should also take steps to determine the extent to which management at the applicable level (e.g., head of the IAIG, ultimate parent company level, insurance holding company level, legal entity level, etc.) is able to provide ongoing risk assessment and oversight of outsourced functions and any contingency plans for emergencies and service disruptions.

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The guidance below provides examiners additional information about the outsourcing of critical functions a typical insurance company may use. The guidance does not create additional requirements for insurers to comply with beyond what is included in state law, but may assist in outlining existing requirements that may be included in state law and should be used by examiners to assess the appropriateness of the company's outsourced functions. Within the guidance, references to relevant NAIC model laws have been included to provide examiners with guidance as to whether compliance in certain areas is required by law. To assist in determining whether an individual state has adopted the provisions contained within the referenced NAIC models, examiners may want to review the state pages provided within the NAIC's *Model Laws, Regulations and Guidelines* publication to understand related legislative or regulatory activity undertaken in their state.

Types of Service Providers

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

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

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

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

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

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

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

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

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

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Investment Advisers

As investments and investment strategies grow in complexity, insurers may consider the use of investment advisers to manage their investment strategy. Investment advisers may operate independently or as part of an investment company. Investment advisers and companies are subject to regulation by the U.S. Securities and Exchange (SEC) Commission and by the states in which they operate generally based on the size of their business. In certain situations, insurers may use a broker dealer in the capacity of an investment adviser. Broker dealers are subject to regulation by the Financial Industry Regulatory Authority (FINRA). Regardless, most broker dealers and investment advisers will register with the SEC and annually update a Form ADV, which provides extensive information about the nature of the organization's operations. To locate these forms, the examiner can go to *www.adviserinfo.sec.gov* and perform a search based on the company name.

Key information provided on a Form ADV includes:

a. Locations in which the adviser/broker is registered
b. Information about the advisory business including size of operations and types of customers (Item 5)
c. Information about whether the company provides custodial services (Item 9)
d. Information about disciplinary action and/or criminal records (Item 11)

It is important to note that the information provided on Form ADV is self-reported and is subject to limited regulatory oversight. However, the information may be very valuable to examiners in assessing the suitability of investment advisers providing advisory services to insurers.

Where not prohibited by domiciliary state law and if permitted by the investment adviser agreement, there may be situations in which the investment adviser also acts as a custodian. In these instances, investment advisers are required to obtain an annual examination by an independent public accountant to verify compliance with custodial responsibilities as provided in the federal Investment Advisers Act of 1940 and/or the federal Investment Company Act of 1940. The accountant's report is also available on the Form ADV. It is generally a best practice for the insurer to choose a national bank, state bank, trust company or broker/dealer which participates in a clearing corporation, other than its investment manager/advisor, to hold its assets in custody to promote segregation of duties. See additional discussion under the topic of "Custodian" above for more information.

In performing risk-focused examinations, examiners should identify all advisers utilized by the insurer and take steps to address any significant risks associated with their use. These steps may include determining whether investment advisers are suitable for their role (including registered and in good standing with the SEC and/or state securities regulators), performing procedures to ensure investment advisory agreements contain appropriate provisions, and performing procedures to ensure that the adviser is acting in accordance with the agreement. Additionally, the examiner may consider performing procedures to determine if management/board oversight of the investment adviser is sufficient for the relationships in place.

In evaluating the provisions of the investment advisory/management agreements, examiners should consider whether there are appropriate provisions to adequately address selection of investments, authority

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for transactions, conflicts of interest, calculation of fees, etc. Additional considerations for use in reviewing the investment advisory/management agreements are provided as follows:

a. Selection of Investments

It should be clear from the advisory agreement, how the investment adviser will select investments. This should include specific ~~reference to the insurer's investment strategy~~and detailed investment guidelines attached as part of the agreement.

b. Authority for Transactions

Advisory agreements should address the level of the authority that will be given to the investment adviser in executing transactions.

c. Conflicts of Interest

~~To the extent that any conflicts of interest may be known to the insurer, t~~The advisory agreement should specifically indicate the manner in which such conflicts of interest will be considered. This is an important protection against an investment adviser's biases as a result of business arrangement (e.g., referral relationships, affiliate product offerings, etc.) that may interfere with the proper execution of the investment strategy. This is an important consideration when the investment adviser has other clients. For example, investment advisers often have affiliates that offer investment options that should be available to the insurer but should not be given preferential treatment if competitor products are determined to be a better fit for the selected investment strategy. The reporting of potential conflicts of interest and how they are addressed should also be included in the insurer's management and controls framework.

d. Fiduciary Responsibility

It is advisable that the investment advisor is registered with the SEC. However, whether or not that is the case, the agreement should acknowledge that the investment advisor is subject to guidance and requirements under the Investment Advisors Act of 1940. Language provided in the investment management agreement should acknowledge the investment adviser's role as a fiduciary in advising the insurer. This is an important legal distinction that may help protect the insurer's interests in the execution of the company's investment strategy. The fiduciary standard is generally implied when an asset manager is registered as an investment advisor, which may be required at the federal (SEC) or state level (state securities regulator) depending on the nature and extent of services provided. If not already performed by the financial analyst, the exam team should consider confirming whether the advisor is formally registered in accordance with existing legal requirements and in good standing with its securities regulators. If the advisor asserts that it is exempt from registration requirements, the exam team should consider verifying that the advisor continues to meet the exemption criteria.

e. Calculation of Fees

Management fees should reflect the current market conditions and should reflect the kind of assets and type of asset management performed. It is important that the manner in which fees are calculated is well defined in the management agreement and that the structure of the fee is considered as management assesses the adviser's performance. For example, if the advisory fee is computed based on volume of transactions, it would be important for management to closely review the frequency of trades to help avoid excessive charges Special attention should be paid if there are any performance or incentive fees over and above a base management fee. In the case of affiliated asset managers, special attention should be paid to the total amounts paid by the insurer to guard against such fees becoming a way around dividend restrictions.

f. Sub-advisors

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Can the investment advisor engage sub-advisors? Is consent of the insurer required, or can the insurer revoke the engagement? Who is responsible for the fees of the sub-advisor and are they included in the overall fee structure (i.e., not overlapping)?

g. Reporting

Are there adequate provisions for reporting to the insurer on regular basis. There should be provision for any regulatory needs and any other needs of the insurer that are within reason.

h. Termination

Are there appropriate termination provisions, both with and without cause? Is there language providing for the transition to another investment adviser.

~~f.~~i. Review of Performance and Compliance

Agreements should include consideration of information that will be provided to the company to permit the company to perform adequate review of the adviser's performance and execution of the investment strategy, including compliance with adopted investment guidelines.

There may be other terms that examiners consider to be significant and can therefore tailor their review based on judgment and the specifics of the insurer under exam. For related guidance regarding affiliated investment manager agreements, please see Section V. C. Domestic and/or Non-Lead State Analysis – Form D Procedures of the NAIC's *Financial Analysis Handbook*.

Examiners may consider leveraging risk, control and test procedure language provided in the Investment repository when determining an appropriate examination response. The examiner may also consider concepts discussed in the "Other Third-party Administrators (TPAs)" and "Custodial or Safekeeping Agreements" to ensure that risks are adequately addressed as part of examination fieldwork.

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Examination 2 – Investments Repository Excerpts

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
Other Than Financial Reporting Risks						
The board of directors (or committee thereof) and management do not effectively monitor or supervise contracted third parties (including affiliates) in the implementation of the investment policy/strategy. *See Section 1 Part III of the Handbook for additional guidance relevant to reviewing third-party investment advisers and associated contractual arrangements.	CR MK	Other	AIPS	Prior to entering into a contract with a third party, management reviews the third party's credentials to ensure that they are qualified to perform the service and verifies that no conflict of interest exists. Management ensures that third-party contracts include appropriate provisions and recognize fiduciary responsibility to the insurer. Contracts are reviewed for appropriate provisions related to: • Investment guidelines/selection. • Authority for transactions. • Reporting of transactions in sufficient detail and frequency. • Conflicts of interest. • Appropriateness of fees.	Review procedures that ensure management reviews the credentials, including confirming registration as investment advisor/manager, of the third party and that no conflict of interest exists. Verify the insurer control to ensure appropriate contract provisions. Specifically consider any situations and transactions where the potential of conflict of interest exists. This includes transactions with other accounts managed by the third-party manager, through brokers affiliated with the third-party manager and investments in funds managed separately by the third-party manager.	Assess the suitability of investment advisers through a review of information provided to the U.S. Securities and Exchange Commission (SEC) in Form ADV (if available) or other available information. Determine if there are any disciplinary actions or background information that might call into question the advisers' suitability for providing services rendered. Review significant investment advisory/management agreements for appropriate provisions. Review recent performance and benchmark reports in comparison with the company's plan. Test the insurer's investments for compliance

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				• Review of performance. • Termination. The insurer monitors investments purchased, those sold, the performance of the investment portfolio against prior year or budgeted results, and what the insurer holds. It also monitors compliance with the investment strategy that has been established by the board of directors (or committee thereof). This monitoring can be performed by senior management, an investment advisory board or internal auditors and is reported to the board of directors (or committee thereof). Processes are in place to ensure proper disclosure, regulatory approval (if applicable) and reporting of all authorized investment advisors and sub-advisors.	Obtain a copy of the report that is used by the insurer to report investment policy compliance to the board of directors (or committee thereof), and verify the board's review of the investment activity. Verify that a discussion of investments took place at the board of directors (or committee thereof) meeting by reviewing a sample of meeting minutes. Review and test company processes in place (including supervisory review) to ensure proper disclosure, reporting, and regulatory approval (if applicable) of all authorized investment advisors and sub-advisors	with its investment policy guidelines. Assess significant changes in portfolio profile year over year and over the course of recent years to determine suitability of changes for the company. Verify that all investment management agreements with affiliated entities have been filed with the department for approval. Verify that information related to investment advisors is properly disclosed in the general interrogatories.

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
						Verify that information on investments is properly reported as to the affiliated/related-party status in the annual statement investment schedules.
Structured security or other complex investments originated and managed by an affiliate or related party may present an increased exposure to solvency risks.	CR ST MK	Other	AIPS VIIA	The insurer verifies that its affiliate/related party asset manager has adequate experience and knowledge in originating and managing the types of investments held by the insurer. The insurer verifies that its affiliate/related party asset manager follows appropriate underwriting practices in originating investments. The insurer has established guidelines for investments originated and managed by affiliates/related parties to ensure that: • The fee structure is transparent, ~~and~~ equitable, and	Review documentation demonstrating that management reviews the credentials of the affiliate/related party, including confirming registration as investment advisor/manager and that no conflict of interest exists. Review internal audit (IA) work, board minutes, and/or other documentation demonstrating effective oversight of the affiliated asset origination process. Review documentation demonstrating that the insurer has reviewed the investments originated and managed by an affiliate or related party for compliance with regulatory investment limitations and reporting requirements.	Review significant investment advisory/management agreements for appropriate provisions. Test the insurer's investments for compliance with its investment policy guidelines and regulatory requirements. If necessary, use an investment specialist to analyze the insurer's structured securities portfolio. Review Jumpstart reports to identify potential designation exceptions for structured securities and address exceptions, as appropriate. If deemed necessary, review individual securities for

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				avoids overlapping and excessive fees. • Concentration of such investments is in accordance with affiliated investment limitations. • Investments offered to the public are in compliance with applicable requirements. The insurer has a process in place to have its structured securities effectively rated by a qualified third party and assesses the appropriateness of ratings and designations. The insurer has a process in place to ensure that investments managed and originated by affiliates/related parties are properly identified and reported in accordance with statutory accounting guidelines. • This includes proper classification of	Obtain documentation demonstrating management's review and approval of third-party ratings for structured securities. Review the insurer's process for identifying reporting investments managed and originated by affiliates/related parties, and determine whether it is operating effectively. Obtain documentation demonstrating how management determines the	compliance with NAIC designation reporting requirements. If deemed appropriate, select a sample of material investments and review the underlying details to determine if the investments are properly classified in the respective investment schedules in the annual statement.

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				holdings reported in the “Investments Involving Related Parties” column of each investment schedule in the annual statement.	classification of investments in the annual statement.	

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 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 a key activity matrix, but not both.

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

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

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 sevenphase 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 wp A.1.4).* *Obtained and reviewed the economic capital calculation at 12/31/XX, noting that rating agency considerations are included in the process and that the company appears to hold capital in excess of the calculated amount. See*	*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).*

DETAIL ELIMINATED TO CONSERVE SPACE

Overarching Prospective Risk Identified	Branded Risk	Risk Mitigation Strategies	Investigate Risk Exposure	Risk Assessment Level	Trend	Rationale	Communicate Findings to Financial Analysis
Note: Only P/C insurers.		*of directors at the next annual meeting.*					*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 changes in estimated future exposures.*
Example Prospective Risk #5: *The company's executive compensation plans include incentives based on financial metrics which may*	*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.*	*Obtained the board minutes to ensure board review and approval of the executive compensation plan structure, which does incorporate some long-term goals. However, much of the incentive compensation*	*Moderate*	*Increasing*	*The Company's executive compensation plan has been reviewed and approved by the Board; however, the incentives are largely dependent upon some*	*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*

Overarching Prospective Risk Identified	Branded Risk	Risk Mitigation Strategies	Investigate Risk Exposure	Risk Assessment Level	Trend	Rationale	Communicate Findings to Financial Analysis
encourage riskier decision making.		*The Company pays out incentive compensation based on 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.*	*continues to be based on short-term growth and performance goals (Refer to A.4.2).* *Obtained and reviewed detailed support for incentive payment calculations, verifying the accuracy of calculations in accordance with the written plan. Also reviewed and verified the Company's claw back policy. (Refer to A.4.5).*			*metrics (i.e., annual premium growth) that have the potential to encourage excessive risk taking by executives.*	*compensation structure.* *Review the Corporate Governance Annual Disclosure (CGAD) for information referring to the executive compensation practices and follow-up on any changes identified.*

PART TWO – COMMON AREAS OF CONCERN

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

Prospective Risk Category	**Comments**
Merger and Acquisition Activity	If applicable, review the company's process to identify and perform due diligence on potential acquisitions. In addition, consider reviewing the company's process to integrate acquired entities and business into its systems.
Product Development	If applicable, review and assess the company's process to identify, develop, price and market new products in accordance with the company's strategy and business needs.
Legal and Regulatory Changes	If applicable, review how the company identifies, monitors and addresses changes to the legal and regulatory environment it operates within. For example, review the company's processes in place to analyze the impact that health care reform could have on the company, including support for company projections and strategies for appropriateness.
HR/Personnel Risks	If applicable, review and assess the company's HR processes to identify, mitigate and monitor risks related personnel management (including succession planning for critical positions) as well as hiring, managing, retaining and terminating personnel in accordance with company needs.
Strategic Planning	If applicable, review and assess the company's processes for strategic planning to determine whether the company regularly analyzes its strengths and weaknesses, as well as opportunities and threats, on an ongoing basis. In addition, it might be appropriate to review the company's process to update its overall business plan on a regular basis.
Compensation Structure	If applicable, review the company's process for developing, ~~monitoring~~monitoring, and adjusting its compensation structure to ensure that employees are appropriately compensated without creating an incentive to misrepresent financial results or take excessive risks.
Rating Agency Downgrade	If applicable, review the company's process to monitor and prepare for potential adverse changes in its credit ratings. If a future rating agency downgrade is deemed likely, consider whether the company is adequately prepared to handle the results of such a downgrade.
Costs of Capital	If applicable, review the company's access and ability to obtain capital, reinsurance and letters of credit, if necessary, to meet funding and risk diversification needs.
Business Continuity	If applicable, review the company's business continuity plan. Follow the steps outlined in Section 1, Part III.
Climate Change	If applicable, review the company's process for identifying and monitoring risks resulting directly or indirectly from the impact of climate change risk. The insurer may assess energy transition and asset devaluation risk on its investment portfolio, or physical risk due to climate change with scenario analysis or modeling. If material, the company should evaluate the impact of climate risk on its longer-term business strategy and inform its board of directors regarding the results of transitional and physical risk stress scenarios and modeling.
Provider Contracting (Health)	If applicable, review the company's process for negotiating contracts with key providers and ensuring an adequate and competitive provider network.

EXHIBIT Y

EXAMINATION INTERVIEWS

Overview

Interviews are a useful examination tool to gather information about key activities, risks and risk mitigation strategies. Employees can also provide information on fraudulent activity within the company. It is critical for the examination team to understand and leverage the company's risk management program; i.e., how the company identifies, controls, monitors, evaluates and responds to its risks. The discipline and structure of risk management programs vary dramatically from company to company. Interviews should be performed in the early stages of the examination so that regulators can adjust their procedures accordingly. An examiner can perform alternate, additional or fewer detail and control tests as a result of interviews with the company.

Interviews should be conducted with key members within management of the company, as well as members of the board of directors, audit committee, internal/external auditors and any other employees deemed necessary. These interviews can be used at the beginning of the examination or at any time during the examination, as necessary. In order to conduct a productive interview, the examiner should have a basic understanding of the company prior to commencing the interview process. When possible, the examiner should meet with the department analyst prior to scheduling interviews with company personnel to assist in gaining this basic understanding. Examiners should continue to tailor each interview as information is learned about the company throughout the planning process.

Examiners should consider the size and complexity of the organization in determining which individuals to interview. The interview process is a key step in the "top–down" approach, beginning with senior management and then drilling down through the various levels of management to obtain a thorough understanding of the organization to assist in scoping the examination. In order to select the individuals to interview, the examiners should obtain an organizational chart from the company and compile a list of potential interviewees. Interviews of board members and senior company management should be conducted by examiners who possess the appropriate background and training. The examiner should also carefully consider the order of interviews, as information gleaned from certain "C"-level individuals can inform subsequent interviews. For example, the Chief Risk Officer (CRO) is uniquely positioned to have an awareness of the various risks facing the company from multiple perspectives. The information obtained through an interview with the CRO can help the examiner have a greater understanding of the key risk areas of the company, which can then be used to further customize subsequent interviews, as well as determine which additional members of management should be interviewed. This may be particularly important if the company under examination is part of a larger coordinated holding company group exam as the CRO at the enterprise level reviews and establishes risks for the holding company as a whole. Questions asked of management of each regulated entity in the holding company group, such as those for climate-related risks, may be more appropriately directed to the CRO. While it can be challenging to coordinate the interview schedule with company personnel at this level, examiners are encouraged to attempt interviewing the CRO as early in the interview process as possible.

If the company under examination belongs to a holding company group that has been identified as an internationally active insurance group (IAIG), as defined in the *Insurance Holding Company System Regulatory Act* (#440), the group-wide supervisor should consider conducting additional interviews at the head of the IAIG, including key members of management and the board of directors. Such interviews would assist the group-wide supervisor in determining the consistency of governance practices across the IAIG, as well as whether the group's risk management framework encompasses the head of the IAIG and legal entities within the IAIG.

DETAIL ELIMINATED TO CONSERVE SPACE

Sample Interview Questions for Board or Committee Members

Experience and Background

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

Duties and Responsibilities

- How often does the board/committee meet? Why is that sufficient?
- Briefly describe your duties and responsibilities, including what types of company information you monitor on a continuous basis.
- How does management establish objectives and how does the board of directors monitor achievement of those objectives?
- What role does the board of directors play in determining executive compensation?

  The following questions may be appropriate for a member of the compensation committee for further details surrounding the company's executive compensation structure:

  - Describe how incentive programs are structured. What metrics are used? What percentage of the incentives are short-term vs long-term?
  - How does the board ensure that the compensation policy is in line with stakeholder interests?
  - How does the board ensure that the compensation policy does not incentivize excessive risk taking?
  - How often are compensation and incentive plans evaluated for any adjustments or updates?
- What areas are discussed and what type of decisions are made by the board/committee?
  - How does the board ensure that sufficient information is received to make informed decisions on behalf of the company?
- Does the board/committee review related-party transactions?
- What role does the board/committee play in overseeing the actuarial function as well as associated internal controls?
- Do you have a board member or committee that is responsible for monitoring the financial risks (short-term and long-term) associated with climate change?
  - How often and at what level of detail does the board discuss these risks?

Reporting Structure

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

Ethics

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

Risk Areas

- How does the board identify and monitor key risks faced by the company?
  - What are the key risks the board has identified?

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.

DETAIL ELIMINATED TO CONSERVE SPACE

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
and future business operations.				Underlying assets to be considered may include: • Deferred tax assets • Significant receivables • Goodwill • Investment in subsidiary • Encumbered assets • Defined benefit pension asset The insurer maintains documentation regarding permitted practices that could impact the quality of available capital and reviews all associated calculations to ensure compliance.	Obtain documentation of the insurer's review of its compliance with permitted practices.	consideration of the liquidity of the assets under review. Review the make-up of the insurer's capital and assess how the categories (e.g., common stock, preferred stock, surplus notes, paid-in-capital, etc.) support the ongoing and future business operations. Review the insurer's calculations to ensure they comply with the permitted practices granted by the domiciliary insurance commissioner. Review the effects of the permitted practice on RBC calculations, including subsequent examination adjustments.
The insurer is not accurately calculating, reporting and monitoring RBC, including any manual adjustments to RBC charges (i.e., 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.	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	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)

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				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 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.	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 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.	in accordance with SSAP guidance and RBC instructions. Compare the data provided in the RBC filing against other filings and information available to the department for consistency. (This procedure may only be necessary for values not obtained directly from the annual financial statement and not subject to the NAIC RBC crosscheck procedures.) Determine the impact of examination changes on the RBC calculation. Compare the modeling approaches, assumptions 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.

