Draft date: 2/18/2025
Virtual Meeting

RISK-FOCUSED SURVEILLANCE (E) WORKING GROUP
February 26, 2025
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

Amy Malm, Chair	Wisconsin	Tadd Wegner	Nebraska
Johanna Nickelson, Vice Chair	South Dakota	Paul Lupo	New Jersey
Blase Abreo	Alabama	Mark McLeod	New York
Laura Clements/Michelle Lo	California	Jackie Obusek/Monique Smith	North Carolina
Jack Broccoli/William Arfanis	Connecticut	Dwight Radel/Tracy Snow	Ohio
Carolyn Morgan/Jane Nelson	Florida	Eli Snowbarger	Oklahoma
Cindy Andersen	Illinois	Ryan Keeling	Oregon
Roy Eft	Indiana	Diana Sherman	Pennsylvania
Daniel Mathis	Iowa	John Tudino/Ted Hurley	Rhode Island
Melissa Gibson	Louisiana	Amy Garcia	Texas
Vanessa Sullivan	Maine	Jake Garn	Utah
Dmitriy Valekha	Maryland	Dan Petterson	Vermont
Kristin Hynes	Michigan	Jennifer Blizzard/Greg Chew	Virginia
Danielle Smith/Shannon Schmoeger	Missouri	Tarik Subbagh/Steve Drutz	Washington

NAIC Support Staff: Bruce Jenson/Jane Koenigsman

AGENDA

1. Discuss Comments Received and Updated Draft of Contractor Oversight Guidance—*Amy Malm (WI)*
    a. Interested Party Comment Letter — Attachment A-1
    b. GA Comment — Attachment A-2
    c. Updated Draft of Guidance — Attachment A-3

2. Discuss Referral Received from Chief Forum on Reciprocal Exchanges—*Amy Malm (WI)* — Attachment B

3. Any Other Matters—*Amy Malm (WI)*

4. Adjournment

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December 10, 2024

Amy Malm, Chair
Risk-Focused Financial Surveillance (E) Working Group, National Association of Insurance Commissioners
1100 Walnut Street, Suite 1500
Kansas City, MO 64106-2197
By e-mail to Bruce Jenson at: bjenson@naic.org

Re: Exposure on Proposed Changes to the NAIC's Financial Analysis and Financial Condition Examiners Handbooks Pertaining to the Use of Contractors

Dear Ms. Malm:

Interested parties ("IPs") appreciate the opportunity to comment on the above-captioned item that was exposed by the Risk-Focused Financial Surveillance (E) Working Group, ("RFSWG") with a comment deadline of December 10.

The interest of IPs in this matter originated with an earlier exposure by the NAIC's Financial Regulation and Accreditation Standards (F) Committee (the "F Committee") to which IPs responded in its comment letter dated September 27, 2014. While IPs took no exception to the suggested revisions in that earlier exposure, we commented that such revisions did not adequately address certain risks involved in a state insurance department's use of contractors and that those matters should first be addressed on a technical level by the RFSWG. Once the RFSWG resolved any additional guidance in the Financial Analysis Handbook ("FAH"), any enhancements could then be considered by the F Committee for possible future revisions to the NAIC's Accreditation Manual and its guidance for Accreditation reviewers.

By time the IPs' comment letter of September 27, 2024, was sent to you and your colleagues on the RFSWG, the RFSWG was already well on its way to developing its own exposure draft of proposed revisions to both the FAH and the Financial Condition Examiners Handbook (FCEH) pertaining to the use of contractors. The RFSWG decided to proceed with the release of its exposure rather than hold it up for further input at that time by IPs. However, IPs were given the opportunity to provide further comment during an extended exposure period, for which IPs are appreciative.

IPs have provided detail comments in the attachment to this letter, but also provide below a recap of some of the key points that were included in our September 27, 2014 comment letter to the F Committee. IPs believe that these points continue to apply in the case of the current exposure pending before the RFSWG:

1. First, our primary concern is the apparent increased involvement in recent years of contractors in the state regulatory financial analysis function, a trend which is acknowledged in the F Committee's referral to RFSWG.
2. Second, IPs understand and have also experienced the resource constraints that state insurance departments are experiencing in the current environment to attract and retain qualified personnel, a phenomenon that is impacting both the public and private sectors in various ways. Balancing the need to address the shortage of qualified personnel with the issues associated with the use of contractors, any use of contractors – whether in the private or public sector – calls for the use of appropriate guardrails to assure the quality of work performed and avoid unintended consequences and risks.
3. Third, there are certain aspects involving the use of contractors that are not covered currently in the NAIC Financial Analysis Handbook. These include guardrails which address not just the supervision, review and timeliness of work performed, but also matters such as the independence of the contractor (and/or his/her firm); any potential conflicts of interest they may have and the ongoing responsibility to report any changes promptly; the confidentiality of insurer-specific information or proprietary processes with which the contractor may come into possession or knowledge in the course of their work on behalf of the state; the security and data governance over that information including in electronic format and transmissions.
4. Fourth, the use of contractors for financial analysis should only be undertaken on a temporary basis until such time as the state insurance department is able to hire qualified personnel. Full-time personnel provide a continuity of involvement with the insurers that are the subject of their analyses; state insurance departments, as well as insurers, benefit from their in-house knowledge and experience with insurers over time. Having the analysis performed by state insurance department personnel provides that continuity of involvement and should be the long-term goal of the insurance department.

The materials that comprise the RFSWG's current exposure consist of four documents that are posted on the Exposures Tab of the RFSWG's web page. The proposed revisions that are included therein focus on some risks that can relate to the use of contractors, e.g., that they may not be adequately qualified, that an appropriate level of departmental oversight and review be in place, and that their work needs to be performed in a timely manner to fulfill the department's supervisory objectives. In that regard, IPs support the logical framework for such revisions in that risks are identified, and appropriate guardrails are imposed to address those risks. IPs therefore have no comments relative to those proposed revisions.

However, IPs have identified certain other risks that we believe are not adequately addressed either in the current FAH or the RFSWG's current exposure. These are described in the attachment to this letter, along with examples as to how those risks may manifest themselves, and suggested guardrails for the RFSWG to consider through additional guidance in the FAH.

As the RFSWG considers IPs' comments regarding guardrails relative to specific risks involving the use of contractors, there is a pervasive matter that emphasizes an even greater need for state insurance departments to have such guardrails in place involving the use of contractors in the financial analysis function, as compared to the on-site examination function. In the case of examinations, company management provides an additional guardrail in that they oversee the information and data about the company that is provided to the examiner, the means by which such information and data is accessed and secured and can engage with department personnel at the appropriate level of authority should any concerns arise. However, for financial analysis, the contractor would be accessing information about an insurer (or possibly multiple insurers in the case of macro-level or sectoral-wide analysis) directly from the insurance department. This could include not just basic financial information, but many other filings including Own Risk and Solvency Assessments which are not just filed by insurers on a confidential basis but are also subject to legal privilege. Unlike the use of contractors on financial examinations, company management is not in a similar position to serve as a guardrail in the case of such financial analysis work by contractors.

A related matter which can apply to examinations as well as financial analysis is whether company management is even aware of the terms of engagement between the insurance department and the contractor. Such terms should state clearly in writing what the contractor is expected to do and the intended deliverables and deadlines, as well as any other contract or engagement letter requirements that might pertain to some of the risks delineated in the attachment, e.g., the confidentiality of information. IPs believe that fewer states are now entering into 3-party agreements between the department and the contractor and which also includes the company as a signatory acknowledging its awareness of the terms of the contract (and in most cases also acknowledging the company's obligation to pay the contractor's fees). Further, in the majority of situations where the company is not an additional signatory, the company is not otherwise provided the opportunity to see the contract or engagement letter between the insurance department and the contractor. Given that certain of the key risks identified in the attachment may be addressed or mitigated through the contracting process, management should have the opportunity to express any concerns as to whether those terms are adequate in light of the subject matter and the nature of the data and information involved.

* * * * *

Thank you for this opportunity to comment. Please feel free to contact either one of us if you have any questions or would like to discuss further.

Sincerely,

D. Keith Bell Rose Albrizio

cc: Interested Parties
NAIC Staff

Risks Associated with the Use of Contractors

In this attachment, IPs have identified several risk categories for which the FAH should be revised to include additional guidance when a state engages contractors to perform financial analysis. Each category is supplemented with a brief description, some possible examples of what could go wrong, and suggested guardrails for the RFSWG to consider as additional guidance in the FAH.

1. Independence:

Risk: The contractor may not be independent, i.e., there are factors present that could present the appearance of a conflict of interest, if not an actual conflict.

Examples: If, in addition to the state insurance department as a client the contractor has other clients in the industry, or works for a firm that has such other clients, that may present the appearance of, or an actual, conflict of interest:

- The other clients may have matters that are pending or which could come before the Department that involve issues that are identical or similar to those covered by the contractor's financial analysis work for the Department.

- Non-public or proprietary information or data to which the contractor has access in the course of financial analysis work on behalf of the state insurance department may be misappropriated to benefit those consulting/advisory engagements for the contractor's/firm's other clients or otherwise to promote the contractor's/firm's business.

Suggested Guardrails: IPs recommend that the RFSWG adapt the relevant guidance in the Financial Condition Examiners Handbook (FCEH) and apply it for use in the Financial Analysis Handbook (FAH). In that regard, FCEH section *III.G. Use of Independent Contractors on Multi-State Examinations*, subsection *4. Conflicts of Interest*, is pertinent. That text is as follows, with suggested revisions to adapt it for use in the FAH:

> Conflicts of interest may occur if the financial analysis ~~an examination~~ of a company is performed, or related advice regarding the company is provided, by an independent contractor who has a significant relationship with the company, its affiliates, or their management (financial or non-financial) that may impair in fact, or in appearance, the independent contractor's independence. To evaluate any such conflicts of interest, the insurance department should request a disclosure letter from the independent contractor regarding their past, present or planned relationships, both financial and non-financial, with the examined company or its affiliates. The disclosure letter should discuss the nature of the services provided by the independent contractor and the amount of fees paid to the CPA by the company over the preceding five years.
>
> Determining whether a potential conflict of interest exists is a matter of considerable judgment. As independent contractors provide many different types of services (e.g., accounting, auditing, actuarial, management and tax consulting), it will be necessary to evaluate the nature of services provided and the amount of fees involved when determining whether a potential conflict of interest exists.

Risks Associated with the Use of Contractors

However, in the conduct of financial analysis work, other types of potential conflicts of interests may by presented which go beyond the above guidance from the FCEH. Thus, it is recommended that the following text be considered by the RFSWFG as additional guidance for the FAH:

> Unlike an examination where a contractor's work involves a single company or related group of companies, an analyst may be involved with peer analysis which could involve many unrelated insurers involved in a particular line of business, or even sector-wide analyses. The contracting analysist's findings and recommendations could therefore have potential implications across a cohort of companies, some of which may be clients of the contractor or his/her firm.
> There may also be conflicts involving the specific issues that impact various insurers; the contracting analyst may find themselves assessing and providing advice on an issue involving an insurer on behalf of the state insurance department, while the analyst's firm may also be providing potentially different advice to the firm's other clients, or basing advice to other clients on confidential information accessed from their engagement with the insurance department.
>
> Situations like those described in the preceding two paragraphs are more likely to occur when the individual being contracted is employed by a firm that also serves clients in the industry. Industry knowledge and specialization is a beneficial attribute to consider when states are seeking analysis services. However, the state should also consider the likelihood of a broader array of potential conflicts that may also exist in the absence of sufficient guardrails. The insurance department should request, as part of the disclosure letter referred to above, that the contractor's firm describe:
>
> - All relationships between the contractor, the contractor's firm or any affiliates of the firm with entities that are regulated by the Department for which the anticipated services of the contractor may have some impact, directly or indirectly, on the Department's oversight of such entities.
>
> - The specific controls that are in place to assure that such potential conflicts do not exist.
>
> The written description should be required to be updated at least annually, and again subject to review by the Department to assure that there are no matters that a reasonable person might conclude could present a conflict of interest.

2. Confidentiality

Risk: The contractor may not adequately protect, or have the ability to protect, the Department's or an insurer's confidential or privileged information.

Examples: Confidential data or other information that the contractor has access to pursuant to their financial analyses work for the Department, including the nature of any findings, conclusions, discussions with Departmental personnel or with company personnel or management, or privileged

Risks Associated with the Use of Contractors

material such as an ORSA Annual Report or any analyses thereof, are shared or leaked to non-authorized persons or organizations.

Suggested Guardrails: The engagement letter or contract should include standard confidentiality provisions that provide for adequate protection of all insurer data and information that the contractor might have access to in the course of their work for the state. These confidentiality provisions should be compliant with statutory confidentiality provisions such as those in the Risk Management and ORSA Model Act and the Corporate Governance Annual Disclosure Model Act. They must include that the contractor affirmatively state in writing that it has both the intent and ability (including legal authority) to protect any confidential or privileged information.

Additional contractual provisions or Departmental procedures may also be necessary depending upon whether the contractor's work is done on-site at the Department or remotely, and whether access to information is achieved through use of Departmental technology resources and platforms or the contractor's own resources and platforms.

3. Security of Company Data and Information

Risk: Company information, whether hard copy or electronic, may not be maintained in a reliably secure manner

Examples: Company information, if not adequately secured with restricted access, may be misappropriated by unauthorized players in various ways. Examples of company data which may be vulnerable includes electronic transmissions sent over non-secure channels, data stored on devices that are not encrypted or adequately restricted, and passwords that are not adequate or changed regularly.

Suggested Guardrails: Examination practices should include a signed Data Security and Confidentiality Agreement ("Agreement"), detailing the contractor's obligations to keep all information and data reviewed or obtained during the course of the engagement with the department confidential and maintained in a secure environment with access limited only to listed authorized personnel.

The Agreement should include an obligation to report any breach or unauthorized access or disclosure to the department and must provide for the state and any aggrieved party with the right to seek injunctive relief against the contractor in the event of a data breach or the contractor's use of the examination or analysis data for any purpose outside of their work for the department.

The Agreement should also require the use of a secure file transfer protocol for delivering information and employ best practices for encryption and/or access to the information.

4. Institutional Knowledge of the Insurance Department

Risk: The state Insurance Department may experience a loss of institutional knowledge, as a regulatory body, of regulated entities.

Risks Associated with the Use of Contractors

Examples: The State Insurance Department's use of a contractor, whether on a temporary or a long-term basis, may result in the Department's personnel not having or retaining the detailed knowledge related to the contractors' outsourced function and the group being reviewed.

For example, the use of a contractor to document the Insurer Profile Summary will require extensive Department oversight in order for the Department to be familiar with the underling details of the group information. Using a contractor as the subject matter expert instead of a Department employee may limit the Department's ability to respond to subsequent follow-up questions and be dependent upon the Department's access to the contractor. This issue may be further compounded if there is a change in the contractor and or contracting firm in subsequent years.

Suggested Guardrails: State Insurance Departments should retain sufficient detail and repository information over outsourced functions with a designated employee responsible for maintaining sufficient knowledge and oversight of the function.

Georgia Comment

I had one minor comment, regarding Att B4 - APM Review Team Guidelines - Contractor Oversight Edits.

It's regarding this addition:
"If a department elects to use contractors to complete the supervisory review of the examination, the department should demonstrate involvement of appropriate department personnel (i.e., department designees) during the course of the examination in accordance with the Examiners Handbook and the department's policies and procedures. This should result in the department designee providing effective contractor oversight (e.g., status updates, budget oversight), as well as understanding and assessing the overall quality of the work performed."

My comment is that the "e.g., status updates" sounds like it's saying that the designee would be providing status updates because it doesn't have the word "oversight" right after it. It doesn't need it, but then neither does "budget" need "oversight" right after it.

My thought to rephrase it (still understanding that these are examples and not necessarily direct requirements but suggestions of areas to oversee:
This should result in the department designee providing effective contractor oversight (e.g., oversight of status updates, budget, etc.), as well as understanding and assessing the overall quality of the work performed.

Kindly,

Elizabeth F. Nunes, CPA, MBA, PIR
Chief Examiner
(Nunes - pronounced "new-ness")
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NAIC FINANCIAL REGULATION STANDARDS AND ACCREDITATION PROGRAM

REVIEW TEAM GUIDELINES

Part B1: Financial Analysis

a. Sufficient Qualified Staff and Resources

Standard: The department should have the appropriate staff and resources to effectively and timely review the financial condition of all domestic insurers.

Results-Oriented Guidelines:

1. The department should have qualified analysts (including department reviewers) or contractual resources with appropriate skill sets, abilities, knowledge and experience levels to satisfactorily and effectively perform analysis tasks and procedures. Such experience should match the sophistication and complexity of the domestic industry. When assessing whether a department has qualified staff and resources, consideration should be given to the following:
   - The quality of the work performed by the financial analysis staff as documented in the financial analysis files.
   - The financial analysis staff's knowledge and comprehension of the insurance industry and its domestic insurers, as demonstrated during interviews with the staff.

2. The analysis of various financial filings should be completed timely, as discussed in the process-oriented guidelines. If the analysis tasks and procedures were not completed timely, consideration should be given to the size and complexity of the department's multistate insurers and the insurance holding company systems for which the department acts as the lead state. If the analysis tasks and procedures were not completed timely, the department should document the reasons for such, and the review team may take extenuating circumstances into consideration.

Process-Oriented Guidelines:

1. The financial analysts and supervisors, including contractors (if applicable), as well as those reviewing contract supervisor work, should have an accounting, insurance, financial analysis and/or actuarial background, and insurance backgrounds should be financial in nature. College degrees should focus on accounting, insurance, finance, business or actuarial science. Professional designations and credentials may also demonstrate expertise in insurance and/or financial analysis.

2. The analysis of priority insurers should be completed by the analyst and reviewed by the supervisor (including department review of contract supervisor work) by:
   - Annual statements and actuarial-related filings: End of April.
   - Quarterly statements: Within 60 days from receipt of filing.
   - Supplemental filings (excluding holding company filings): Within 60 days from receipt of filing.
   - Holding company filings: by Oct. 31st for analysis conducted by the lead state; by Dec. 31st for analysis conducted by the domestic state.

3. The analysis of non-priority insurers should be completed by the analyst and reviewed by the supervisor by:
   - Annual statements and actuarial-related filings: End of June or if a preliminary analysis, as outlined in the NAIC *Financial Analysis Handbook* (Analysis Handbook), indicates no immediate concerns, then by the end of July.
     - Preliminary analysis performed and relied upon for analysis completion dates should be completed within two weeks from receipt of filing.
   - Quarterly statements: Within 90 days from receipt of filing.
   - Supplemental filings (excluding holding company filings): Within 120 days from receipt of filing.
   - Holding company filings: by Oct. 31st for analysis conducted by the lead state; by Dec. 31st for analysis conducted by the domestic state.

c. Appropriate Supervisory Review

Standard: The department's financial analysis process should provide for appropriate supervisory review and comment. Supervisory review may be conducted by the analyst's supervisor or a senior-level analyst whose job functions include such review duties.

Results-Oriented Guidelines:

1. The supervisory review should be an in-depth and challenging review of the analyst's findings. An in-depth and challenging review should ensure the financial analyses performed are thorough and substantive. When assessing whether the supervisory review is in-depth and challenging, consideration should be given to the following:
   - Substantive review notes provided by the supervisor. Although supervisory review notes may assist the accreditation review team in assessing the supervisory review, they are not required to be created or maintained.
   - The overall quality of the analysis work as documented in the analysis file, including whether all material matters have been identified and adequately discussed.
   - Why issues with the quality of the analysis were not identified and resolved by the supervisor.

2. If a department elects to utilize a contractor to perform the primary supervisory review of financial analysis, an additional level of review is required on the IPS and/or Group Profile Summary (GPS) by a qualified department employee. This review should result in the department employee understanding and assessing the overall quality of the analysis work performed.

Process-Oriented Guidelines:

1. There should be evidence of at least one level of supervisory review on the financial analysis. This does not include scenarios when the company "passed" an automated review, such as the Quarterly Assessment of Non-Troubled Insurers. The supervisory review should be evidenced by sign-off and dating.

2. If the department uses an automated review such as the Quarterly Assessment of Non-Troubled Insurers, and the company did not "pass" the automated review but the analyst documented the rationale that no further documented analysis was necessary, a supervisor should approve the conclusion.

3. The supervisory review should include a review of the risk assessment and significant supporting documentation, and include at least some review of the source documents, the level of which should be based on the experience of the analyst.

4. The supervisory review should be performed within two to three weeks of completion of the original analysis.

5. The supervisory review should include a review of any written responses from the company received by the primary analyst that contain significant information.

6. The supervisory review should include a review of any change in an insurer's priority rating.

7. If the department utilizes a contractor to perform the primary supervisory review of financial analysis, an additional level of review is required on the IPS and/or Group Profile Summary (GPS) by a qualified department employee. This department review should be completed within three weeks of the primary supervisory review, or prior to the overall analysis timeliness deadlines (whichever is sooner).

Part B2: Financial Examinations

a. Sufficient Qualified Staff and Resources

Standard: The department should have the resources to effectively examine all domestic insurers on a periodic basis in a manner commensurate with the financial strength and position of each insurer.

Results-Oriented Guidelines:

1. The department should have qualified examiners (including department designees) or contractual resources with appropriate skill sets, abilities, knowledge and experience levels to satisfactorily and effectively perform examination tasks and procedures. Such experience should match the sophistication and complexity of the domestic industry. When assessing whether a department has qualified staff and resources, consideration should be given to the following:
   - The quality of the work performed by the financial examination staff and/or contractors as documented in the financial examination files.
   - The financial examination staff's and/or contractor's knowledge and comprehension of the insurance industry and the company under examination, as demonstrated during interviews with the staff.

2. The department should have sufficient examination staff and/or contractual resources to appropriately perform necessary target and limited scope examinations.

Process-Oriented Guidelines:

1. The financial examiners and supervisors (including department designees) should have an accounting, insurance, financial analysis, financial examination, information technology (IT) and/or actuarial background, and insurance backgrounds should be financial in nature. College degrees should focus on accounting, insurance, finance or actuarial science. Professional designations and credentials may also demonstrate expertise in insurance and/or financial examinations.

2. The department should perform a full-scope examination on each domestic company in accordance with the respective state law or at least once every five years, whichever is less.

d. Appropriate Supervisory Review

Standard: The department's procedures for examinations should provide for supervisory review of examination workpapers and reports to ensure that the examination procedures and findings are appropriate and complete and that the examination was conducted in an efficient and timely manner.

Results-Oriented Guidelines:

1. The supervisory review should be an in-depth and challenging review of the examiner's findings and the concepts applied in performing the work. When assessing compliance with this guideline, consideration should be given to the following:
   - Depth and challenging nature of supervisory review notes, although maintenance of review notes is not required.

- The overall quality of the work performed, including whether the examination procedures appear to be complete and appropriate and no material matter remains unaddressed.
- Discussions with department staff that verify occurrence and sufficiency of supervisory review, including, but not limited to, the EICs.
- Why issues with the quality of the examination were not identified and resolved by the supervisor.

2. If a department elects to use contractors to complete the supervisory review of the examination, the department should demonstrate involvement of appropriate department personnel (i.e., department designees) during the course of the examination in accordance with the Examiners Handbook and the department's policies and procedures. This should result in the department designee providing effective contractor oversight (e.g., status updates, budget oversight), as well as understanding and assessing the overall quality of the work performed.

Commented [Post1]: From GA Comment

Process-Oriented Guidelines:

1. All workpapers, including work performed by the EIC, should receive at least one level of supervisory review evidenced by sign off and dating by the reviewer.

2. The work of specialists should be reviewed by the EIC for familiarity and understanding.

3. The supervisory review (including department designee review) of planning (Phase 1 and Phase 2), including the Examination Planning Memorandum and risk matrices, should be done before work has begun in Phase 3. The review of planning should include each of the following:
   - Identification of key activities.
   - Identification and assessment of inherent risks.

4. The supervisory review (including department designee review) of Phase 3, Phase 4 and the first part of Phase 5 should be documented by a review of the risk matrices and any associated coaching notes or correspondence before any applicable substantive test work has begun. The review of Phase 3, Phase 4 and the beginning of Phase 5 should include each of the following:
   - Identification and evaluation of risk mitigation strategies/controls.
   - Determination of residual risk.
   - Established detail examination procedures.

5. The primary supervisory review of workpapers should occur within a reasonable period after completion of the item being examined (generally two to four weeks).

6. Upon the conclusion of examination fieldwork, the insurance department's designee should complete the general review outlined in the Review and Approval Summary exhibit of the Examiners Handbook (or substantially similar document) to ensure an appropriate depth of review has been performed.

~~6.~~7. The examination report should be reviewed by at least one person other than the preparer.

~~7.~~8. The examination report should be approved by the commissioner or the commissioner's designee prior to final issuance.

e. General Examination Procedures

Standard: The department's policies and procedures for the conduct of examinations should generally follow those set forth in the Examiners Handbook. Appropriate variations in methods and scope should be commensurate with the financial strength and position of the insurer.

Results-Oriented Guidelines:

1. The examiner should utilize a risk-focused approach and prepare examination documentation in sufficient detail to provide a clear understanding of the work performed. The content and organization of the documentation should support conclusions reached and effective execution of the risk-focused approach. When assessing compliance with this guideline, consideration should be given to the following:
   - Utilization of a risk-focused approach in establishing priority of accounts or operational areas.
   - The clarity and accuracy of the documentation used to support examination conclusions.
   - Extent of involvement with contract examiners if utilized.
   - Utilization of audit work when relied upon to support an identified risk.
   - Fulfillment of coordination efforts as determined by the state in Exhibit Z – Examination Coordination, and consistent with their role as described in the Examiners Handbook, for companies that are part of a holding company group with insurers domiciled in multiple states.

Process-Oriented Guidelines:

1. The examiner should prepare a Risk Assessment Matrix, or substantially similar document, that addresses each of the seven phases.

2. The examiner should prepare a planning memo that includes a discussion of each of the following:
   - Scope and objective of the examination.
   - Materiality assessment.
   - Results of the analytical review.
   - Results of the IT review.
   - Corporate governance assessment.
   - Results of the audit function assessment (internal and external), including review of external auditors' workpapers and reports.
   - Summary of the key activities selected.
   - Scope of the prospective risk assessment procedures to be performed.
   - Intended reliance on work completed by auditors and accredited states (if applicable).
   - Exam staffing and time budgets.

3. If the company being examined is part of a holding company group with insurers domiciled in multiple states, the state should complete the appropriate section of Exhibit Z, Part Two (or similar document) as follows:
   - If the state is the exam facilitator conducting a fully coordinated group examination, Exhibit Z, Part Two, Section B (or similar document) should be completed.
   - If the state is a participating state in a fully coordinated group examination, the state should complete Exhibit Z, Part Two, Section C (or similar document).
   - If the state did not participate in a coordinated group examination or utilized existing work outside of a fully coordinated group examination, the state should complete Exhibit Z, Part Two, Section D (or similar document).

4. The data supplied by the company or an outside source and utilized (relied upon) by the examiners should be tested for both accuracy and completeness in accordance with the respective residual risk assessment.

5. The sampling techniques used should conform to guidance set forth in the Examiners Handbook or other appropriate authoritative guidance.

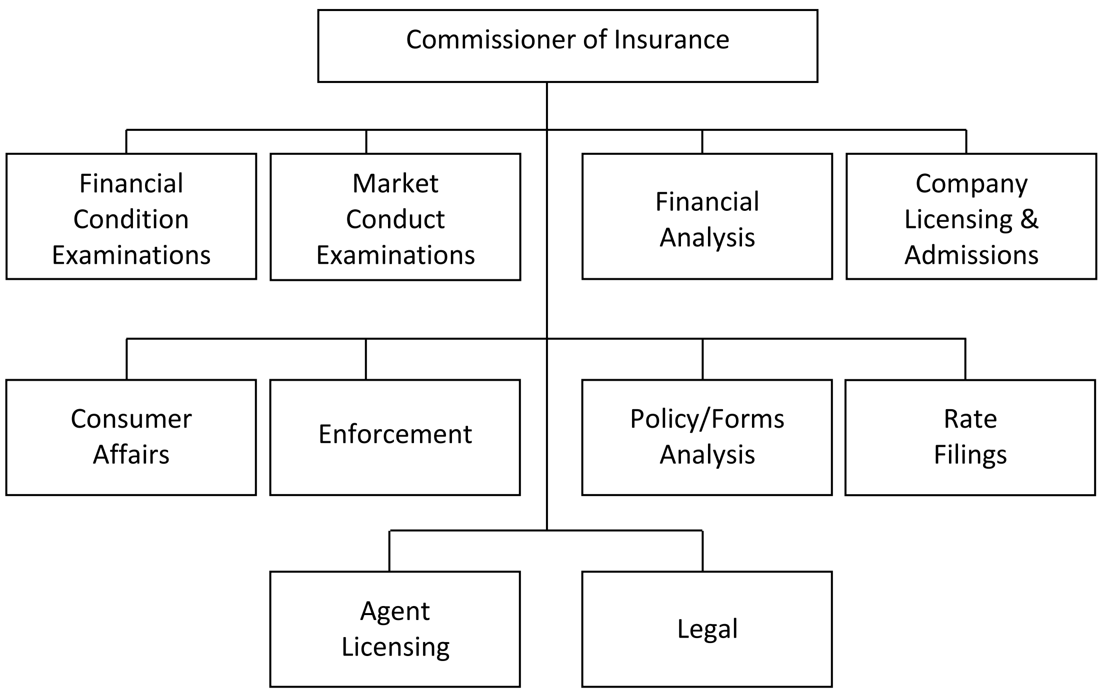
6. If a department elects to utilize contract examiners, the department should demonstrate involvement of appropriate department personnel during the course of the examination in accordance with the Examiners Handbook and the department's policies and procedures.

7. The department should utilize qualified EICs and department designees. The Examiners Handbook provides guidance on the authority, responsibilities and credentials for ~~a~~ qualified EICs and department designees. If the department utilizes an EIC who does not hold the CFE designation or is not directly supervised by someone holding the CFE designation, the department should document in the Financial Exam Electronic Tracking System (FEETS) when calling the exam how this individual is qualified to act in the capacity of an EIC on a multi-state insurer examination. Factors that may be considered include other professional designations, prior insurance experience, familiarity with the NAIC risk-focused surveillance process, etc.

Organization Chart

The organizational structure of a state insurance department varies by state. There are several basic functions that are performed by all departments. It is important for the analyst to understand the purpose of each function and the information obtained that may assist the analyst in the financial monitoring and solvency surveillance process. Due to the variance in organizational structure, the chart below depicts typical state insurance department functions rather than trying to highlight a typical organizational structure.

Chart of State Insurance Department Functional Units



In many states, more than one of the above functions may be performed or supervised by the same individuals. For example, the financial analysts may also perform financial examinations, and financial examiners may also perform market conduct examinations. Additionally, some state insurance departments rely on the Attorney General's office for legal assistance rather than having separate department counsel.

Risk-Focused Financial Condition Examinations

The insurance code in most states allows the state insurance department to examine insurers as often as the insurance commissioner deems appropriate and requires that each insurer be examined at least once every three to five years (as determined by each state). Risk-focused financial condition examinations performed by the state insurance departments include full-scope periodic examinations and limited-scope or targeted examinations, which focus on the review and evaluation of an insurer's business process and controls (including the quality and reliability of corporate governance) to assist in assessing and monitoring its current financial condition and prospective solvency. Through the risk-focused financial condition examinations, the state insurance department gains knowledge about all aspects of the insurer, including its risk management practices and key business activities, which can be useful information to incorporate into the department's ongoing solvency analysis.

The results of a financial condition examination are documented in an examination report that assesses the financial condition of the insurer and sets forth findings of fact (together with citations of pertinent laws, regulations and rules) with regard to any material adverse findings disclosed by the examination. Examiners complete Exhibit AA – Summary Review Memorandum (SRM), or something similar, at the conclusion of the exam. The SRM includes discussion of potential ongoing or prospective solvency concerns, corporate governance, examination adjustments, risk mitigation strategy issues, report findings, management letter comments, responses to issues raised by financial analysts, subsequent events, and other residual risks the examiner may want to communicate to state insurance department personnel. The SRM is a useful tool to communicate information and findings to the analyst, chief examiner, and other state insurance regulators. The final section of the SRM, prioritization level and changes to the supervisory plan, provides discussion of the examiner's overall conclusions regarding ongoing monitoring, including specific follow-up recommended to the analyst.

Additionally, key documents should be available to analysts, including examination reports and management letter comments, which may also include corrective actions required to be taken by the insurer and/or recommendations for improvements.

Market Conduct Examinations

The market conduct examination focuses on such areas as sales, advertising, rating, and the handling of claims. Market conduct examinations evaluate an insurer's business practices and its compliance with statutes and regulations relating to dealings with policyholders and claimants. The results of a market conduct examination are documented in an examination report, which summarizes examination findings so that the insurer's performance can be assessed. The report may also recommend a corrective action to deal with significant problem areas. Because financial conditions and market conduct problems are often interrelated, the examinations are frequently conducted simultaneously. Market conduct examinations are conducted by financial condition examiners in many of the states, usually an impact of the size of the state insurance department.

Risk-Focused Financial Analysis

Risk-focused financial analysis provides continuous off-site monitoring of the state's domestic insurers' financial condition, significant internal/external changes relating to all aspects of the insurer, maintains a prioritization system, provides input into the state insurance department's priority of each insurer, works with the examination staff to develop an ongoing Supervisory Plan and updates the Insurer Profile Summary (IPS), providing department management with timely information of significant events relating to the domestic insurers in assessing prospective risks. The analyst should refer to all available information to monitor the insurer's statutory compliance and solvency on a continuous basis in coordination with the periodic on-site field examination process. As part of the analysis process and the review of the examination report and summary review memorandum, the analyst should incorporate into his/her analysis information gained about the corporate governance and risk management processes of the insurer. If desired, regulators can request the IPS, if applicable, for non-domestic insurers from the domestic or lead state.

As a result of concerns identified during the risk-focused financial analysis process, the insurance department may take a variety of actions, including but not limited to contacting the insurer seeking explanations or additional information, obtaining the insurer's business plan, requiring additional interim reporting from the insurer, calling for a targeted or limited-scope financial condition examination, engaging an independent expert to assist in determining whether a problem exists, meeting with the insurer's management, obtaining a corrective plan from the insurer, and/or restricting, suspending, or revoking an insurer's Certificate of Authority.

Financial Analyst Qualifications

Financial analysts and supervisors (including those reviewing contract supervisor work) should generally have an accounting, insurance, financial analysis and/or actuarial background, and insurance backgrounds should primarily be financial in nature. College degrees should generally focus on accounting, insurance, finance, business, risk management or actuarial science. Professional designations and credentials (i.e., AFE/CFE, APIR/PIR, CPA, CPCU, FLMI) may also demonstrate expertise in insurance and/or financial analysis.

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 use that evaluation in formulating the ongoing surveillance of the insurer. Through their activities, insurers assume a variety of risks, which is the essence of an insurance transaction. The type of risk and its significance vary 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. State 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 uses an organization-wide risk assessment process to enhance evaluation and to better coordinate the activities of financial solvency surveillance through greater consistency within the state insurance 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 state insurance regulators to risk assessment and risk management processes used by insurers will be a positive development.

The enhancements included in the risk-focused surveillance process, including examination and analysis, 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 to determine if there are 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 state insurance 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. For examinations, better formalize and document the risk assessment process via the use of 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. For examinations, 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 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.

ROLE OF THE FINANCIAL ANALYST

In the risk-focused surveillance approach, the financial analyst's role is to provide continuous off-site monitoring of the state's domestic insurers' financial condition, monitor internal/external changes relating to all aspects of the insurer, maintain a prioritization system and provide input into the state insurance department's priority of each insurer, work with the examination staff to develop an ongoing Supervisory Plan as well as update the Insurer Profile Summary (IPS), and provide state insurance department management with timely knowledge of significant events relating to the domestic insurers.

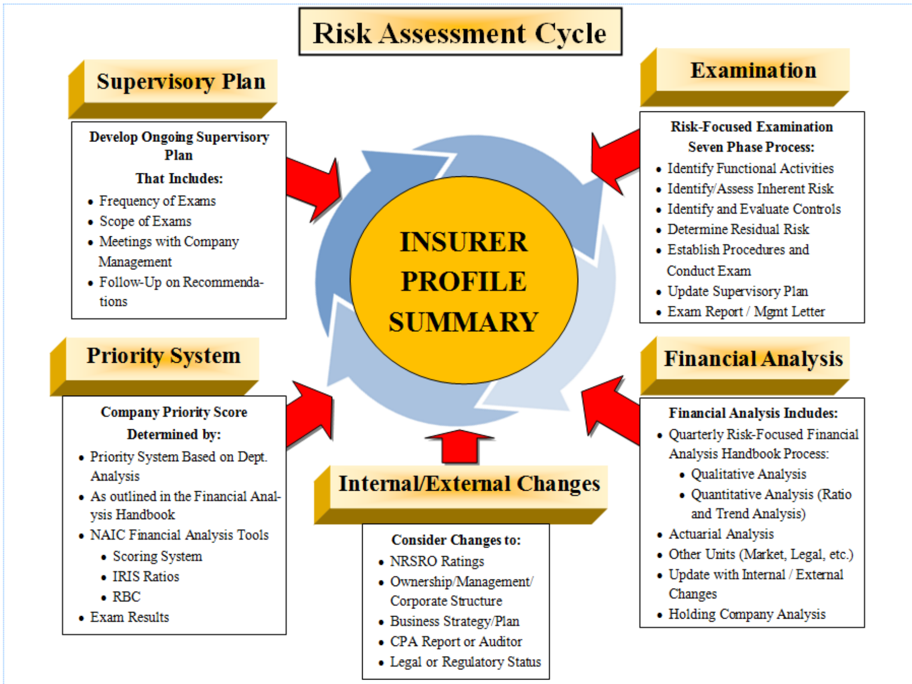
RISK-FOCUSED SURVEILLANCE CYCLE

The risk-focused surveillance framework is designed to provide continuous regulatory oversight. The risk-focused approach requires fully coordinated efforts between the financial examination function and the financial analysis function. There should be a continuous exchange of information between the field examination function and the financial analysis function to ensure that all members of the state insurance department are properly informed of solvency issues related to the state's domestic insurers.

The regulatory Risk-Focused Surveillance Cycle involves five functions, most of which are performed under the current financial solvency oversight role. The enhancements coordinate all of these functions in a more integrated manner that should be consistently applied by state insurance regulators. The five functions of the risk assessment process are illustrated within the Risk-Focused Surveillance Cycle.

As illustrated in the Risk-Focused Surveillance Cycle diagram, elements from the five identified functions contribute to the development of an IPS. Each state will maintain an IPS for its domestic companies. State insurance regulators that wish to review an IPS for a non-domestic company will be able to request the IPS from the domestic or lead state. The documentation contained in the IPS is considered proprietary, confidential information that is not intended to be distributed to individuals other than state insurance regulators.

Please note that once the Risk-Focused Surveillance Cycle has begun, any of the inputs to the IPS can be changed at any time to reflect the changing environment of an insurer's operation and financial condition.



The elements of the risk assessment process are:

- **IPS:** This profile is used to "house" summaries of risk-focused examinations, financial analyses, internal/external changes, priority scores, supervisory plan and other standard information. This profile is intended to be a "living document" and preferably shared with other state insurance regulators who have signed the NAIC *Master Information Sharing and Confidentiality Agreement* verifying that such shared information would remain confidential.
- **Risk-Focused Examinations:** These examinations consist of a seven-phase process that can be used to identify and assess risk, assess the adequacy and effectiveness of strategies/controls used to mitigate risk, and assist in determining the extent and nature of procedures and testing to be used in order to complete the review of that activity. The risk-focused surveillance process can be used to assist examiners in targeting areas of high-risk.
- **Risk-Focused Financial Analysis:** This function consists of a risk-focused analysis processes performed by state insurance regulators as outlined in the *Financial Analysis Handbook* (Handbook). This analysis process identifies and assesses risk based on the nine branded risk classifications to complete and document an overall assessment of the financial condition of the insurer.
- **Internal/External Changes:** Changes in rating agency ratings, ownership/management/corporate structure, financial condition/risk profile, business strategy or plan, external audit reports, and legal or regulatory status should be considered in developing the priority and supervisory plan.
- **Priority System:** The prioritization of the insurer, changes in priority or rationale for changes. See chapter I.F. Prioritization of Work for details.

- **Supervisory Plan:** At least once a year, a supervisory plan should be developed or updated by the domestic state for each domestic insurer. The supervisory plan should be concise and outline the type of surveillance planned, the resources dedicated to the oversight, and the consideration and communication and/or coordination with other states.

Overview of the Risk-Focused Financial Analysis Process

Financial analysis is an ongoing process that can be divided into annual cycles, each of which includes the analysis of the Annual Financial Statement, Quarterly Financial Statements and the various supplemental filings, such as the Actuarial Filings, Management's Discussion and Analysis (MD&A), Audited Financial Report and holding company filings. The financial analysis process is designed to assist the analyst in reviewing and analyzing insurers throughout the annual cycle in a logical manner, focusing on areas of concern within the nine branded risk classifications. The end result of this process is a financial analysis of each insurer specifically tailored to the concerns of that insurer as a result of its unique risks.

Procedure Description	Expectation
Risk Assessment Procedures and Insurer Profile Summary (annual and quarterly).	Complete for all domestic insurers.
Non-Lead State Holding Company Analysis (applies only to non-lead state domestic insurance regulators).	Complete for all domestic insurers that are part of an insurance holding company system.
Lead State Holding Company Analysis Documented within the Group Profile Summary (applies only to lead state domestic insurance regulators).	Complete for all insurance holding company system groups.

Annual/Quarterly Risk Assessment Procedures – Domestic Insurer

Annual and Quarterly Financial Statements

An insurer is required to file an Annual Financial Statement with its state of domicile, the NAIC and all jurisdictions in which the insurer is authorized to transact business by March 1 of each year for the 12 months ended December 31 of the previous year. An insurer is required to file Quarterly Financial Statements for the first, second and third quarters with the state of domicile, the NAIC and, in most instances, all states in which the insurer is authorized to do business by May 15, August 15 and November 15, respectively. The Financial Statement information is loaded onto the NAIC database, at which time automated financial analysis solvency tools are calculated and the Handbook's quantitative results are generated. All of this information is available to the state insurance departments via iSite+.

Scope and Depth of Risk-Focused Analysis

The depth of review will depend on the complexity, financial strengths and weaknesses, and known risks of the insurer and the priority designation established by the state insurance department. Other factors—such as the insurer's past regulatory history, accuracy of filing, age of insurer, stability of business plan, knowledge of insurer's operations, and materiality of the regulatory concerns, etc.— may affect the scope and depth of analysis. The flexibility to customize the scope and depth of the analysis is determined at the state insurance department's discretion and should include analyst and supervisor input. Therefore, the state insurance department should tailor the data and procedures used and the level of documentation to sufficiently address the specific risks of the insurer.

The Risk Assessment procedures for annual analysis consists of an overall analysis of the insurer documented in the nine branded risk classifications. Refer to section III.A.4 Risk Assessment – Analyst Reference Guide for further explanation of the risk classifications. The analyst should perform a background analysis, a current period analysis, and a review of data and procedures within the nine branded risk classification repositories. All of these data and procedures provide the basis for the completion of a thorough review of the insurer's financial solvency.

The nine branded risk classification chapters are designed as "repositories" of data, benchmarks and procedures the analyst may select from in order to perform his/her analysis of that risk category. The analyst's review should use data relevant to each specific risk classification and customized for the insurer such that it is sufficient to perform and document his/her analysis and investigation of risks. Analysts are not expected to respond to all procedures, data or benchmark results listed in the Risk Assessment procedures or the nine branded risk repositories. Rather, analysts and supervisors should use their expertise, knowledge of the insurer and professional judgement to tailor the analysis to address specific risks of the insurer and document completion of analysis. Documentation of the risk assessment analysis should be sufficiently robust to explain the risks and reflect the strengths and weaknesses of the insurer.

At the conclusion of the risk assessment, the analyst should develop and document an overall summary and conclusion based on the results of the risk-focused analysis performed, prospective risks of the insurer, follow-up analysis or regulatory actions, any correspondence and the impact of the holding company on the insurer. The analyst should update the IPS (and supervisory plan, if applicable) to document this summary and conclusion. Note that an analyst's documentation of the risk assessment represents the *detail* of the analysis of risks, which may be more in-depth for certain material risks or complex insurers, whereas the IPS represents a *summary* of the risks of the insurer. Refer to section III.A.4 Risk Assessment – Analyst Reference Guide for further explanation on completing the IPS.

The analysis of annual statements for priority insurers (see section I.F. Prioritization of Work for definitions), including supervisory review, should be completed by the end of April. The analysis of annual statements for non-priority insurers, including supervisory review, should be completed by the end of June, unless a preliminary analysis (see section III.A.4. Risk Assessment ARG for description) indicates no immediate concerns. In that case, the analysis of non-priority insurers should be completed by the end of July.

The analysis of quarterly statements, unless the insurer passes the quarterly non-troubled qualitative review referenced below, should be completed within 60-days of receipt for priority insurers, and within 90-days of receipt for non-priority insurers.

Supplemental Filings

Other supplemental filings to the Annual Statement, including actuarial filings (titles and content vary by statement type), Management's Discussion and Analysis filings, and the Annual Audited Financial Statements and related filings, are required to be reviewed within 60-days of receipt for priority insurers, and within 120-days of receipt for non-priority insurers.

Quarterly Non-Troubled Quantitative Review

For first-, second- and third-quarter financial statement analysis, if the results for the non-troubled automated system calculation (see section III.A.4. Risk Assessment ARG for description) indicate a full quarterly risk assessment should be completed and if it is not, then the analyst should justify and document the reason(s) why. If the results indicate that a full quarterly risk assessment is not required, no quarterly analysis documentation is required to be completed.

If the insurer has been identified as troubled (i.e., Priority 1) or the results of the non-troubled automated system calculation indicate a full quarterly risk assessment should be completed and no justification for not completing one is provided, then the analysis of quarterly statements should be completed within 60-days of receipt for priority insurers, and within 90-days of receipt for non-priority insurers.

Prioritization of Analysis Work

The analyst should ensure that those insurers identified as having significant concerns will be analyzed on a priority basis for future filings. Those insurers with the highest priority should receive the most in-depth review, and are required to be analyzed more frequently, and earlier in each review period. Refer to section I.F. Prioritization of Work for further guidance.

Supervisor Input and Review
It is important for the analyst's supervisor to be actively involved in the financial analysis performed, including determination of the scope and depth of analysis. It also is important that the review and supervision be performed on a timely basis.

The branded risk repositories offer suggestions for the types of information the analyst may consider requesting. It is important that the analyst's proposed follow-up procedures be discussed with the analyst's supervisor.

Use of Contractors in Financial Analysis Work
An insurance department's decision to engage an independent contractor to assist in the completion of financial analysis work may arise due to insufficient department staff or the need for specialized expertise. While the foregoing circumstances may lead an insurance department to contract the services of an independent contractor, the department should consider the long-term effects of not maintaining an appropriate level of qualified staff.

If the department utilizes a contractor to perform the primary supervisory review of financial analysis, an additional level of review is required on the IPS and/or Group Profile Summary (GPS) by a qualified department employee in accordance with the overall timeliness expectations. This review should result in the department employee understanding and assessing the overall quality of the analysis work performed.

An independent contractor is defined as anyone employed by the state insurance department that is outside of the department's staff. When selecting and overseeing an independent contractor to assist in the completion of financial analysis work, the insurance department should evaluate the following:

- **Independence/Conflicts of Interest** – Conflicts of interest may occur if analysis of a company is performed, or related advice regarding the company is provided, by an independent contractor who has a significant relationship with the company, its affiliates, or their management (financial or non-financial) that may impair in fact, or appearance, the independent contractor's independence. To evaluate any such conflicts of interest, the insurance department should request information from the independent contractor on a regular basis regarding its past, present or planned relationships, both financial and non-financial, with the company or its affiliates and utilize this information to ensure that the selected contractor is truly independent from the insurer/group being analyzed.

    - Additionally, if relevant, the insurance department should request and review information provided on all relationships between the contractor, the contractor's firm or any affiliates of the firm with entities that are regulated by the department for which the anticipated services of the contractor may have some impact, directly or indirectly, on the department's oversight of such entities. To the extent that other services are potentially impacted, the department should request and review information on controls put in place by the contractor to ensure that potential conflicts do not exist and/or are not created through assignment of analysis work.

- **Confidentiality Protections** – The state insurance department should ensure that adequate confidentiality protections are incorporated into contracts with independent contractors to ensure that confidential and proprietary information of the insurer/group shared with the contractor for purposes of conducting financial analysis work is adequately protected in accordance with state law and recommended best practices. Such contracts should indicate that any non-public or proprietary information or data to which the contractor has access during financial analysis work on behalf of the state insurance department may not be utilized to benefit consulting/advisory engagements for the contractor's other clients or otherwise to promote the contractor's business. In certain situations, state insurance department might be required to include specific confidentiality language in the contract and/or inform the insurer prior to sharing confidential and proprietary information (e.g., ORSA, Corporate Governance Annual Disclosure) with the independent contractor. As such, state insurance departments are encouraged to review their state requirements before sharing confidential information with an independent contractor.

- **Security and Data Governance** – The state insurance department should ensure that adequate security and data governance practices are in place at the contractor to keep all information and data reviewed or obtained during the engagement with the department confidential and maintained in a secure environment with access limited only to listed authorized personnel. Such practices should include an obligation to report any breach or unauthorized access or disclosure to the department and should include the use of secure file transfer protocol for delivering information and employ best practices for encryption and/or access to the information.

Commented [Post1]: Edits proposed in response to IP comments

Captives and/or Insurers Filing on a U.S. GAAP Basis
These procedures are designed for insurers filing on a U.S. generally accepted accounting principles (GAAP) (or modified GAAP) basis, after the completion of the traditional Risk Assessment Procedures. (See section III.C.1. Special Analysis Procedures – Captives and/or Insurers Filing on a U.S. GAAP Basis Worksheet.) The procedures provide guidance on the review of a GAAP filer on a statutory blank and address the following areas:

- Management assessment
- Balance Sheet assessment
- Operations assessment
- Investment practices
- Review of disclosures
- Assessment of results from prioritization and analytical tools

Domestic and/or Non-Lead State Holding Company System Analysis

Procedures for evaluating and considering the impact of an insurance holding company system on individual insurers should be completed for all domestic insurers. For lead states, this consideration is included within the VI.C Insurance Holding Company System Analysis Guidance (Lead State). For non-lead states, this consideration is included in V.A Holding Company Procedures (Non-Lead State). The depth of the holding company analysis of an insurer in a holding company system will depend on the characteristics (e.g., sophistication, complexity and financial strength) of the holding company system, availability of information, and existing potential issues and problems found during review of the holding company filings. Non-lead states should obtain, utilize and rely on holding company analysis work performed by the lead-state, as appropriate, in fulfilling their review responsibilities. Lead state and non-lead state responsibilities are further defined in section VI.C.

The following procedures are also included within section V.A. Note that Form A, Form D, Form E and Extraordinary Dividends/Distributions are transaction-specific and are not part of the regular annual/quarterly analysis process. The review of these transactions may vary as some states may have regulations that differ from these Forms.

- **FORM A**

The Form A review is to be completed for all acquisitions, mergers or changes in control. Form A is filed with the domestic state of each insurer in the group. The analyst should review the transaction and all applicable documents and complete the Form A Procedures, when necessary.

- **FORM D**
  The Form D review is to be completed for all prior notices of material transactions. Form D must be filed with the domestic state. The analyst should review the transaction and all applicable documents and complete the Form D Procedures, when necessary.
- **FORM E OR OTHER REQUIRED INFORMATION ON COMPETITIVE IMPACT**
  The Form E or other review of competitive impact is to be completed for all pre-acquisition notifications regarding the potential competitive impact of a proposed merger or acquisition by a non-domiciliary insurer doing business in the state or by a domestic insurer. Form E or other required information must be filed with the domestic state. The insurer may also be required to file documents with the Federal Trade Commission (FTC) and the U.S. Department of Justice (DOJ) under the federal Hart-Scott-Rodino (HSR) Act. The analyst should review the transaction and all applicable documents and complete the Form E Procedures, when necessary.
- **EXTRAORDINARY DIVIDENDS/DISTRIBUTIONS**
  The extraordinary dividends/distributions review is to be completed for any domestic insurers planning to pay any extraordinary dividend or make any other extraordinary distribution to its shareholders. Such dividends and distributions must receive proper prior regulatory approval. The analyst should review the transaction and all applicable documents and complete V.E Extraordinary Dividends/Distributions Procedures, when necessary.

At the end of section V.A., the analyst is asked to develop and document a conclusion regarding the impact of the holding company system on the domestic insurer and update the IPS accordingly by Dec. 31 each year. In addition, the analyst is encouraged to notify the lead state of any material risks or events that the lead state may not be aware of, that should be considered in the evaluation of the overall financial condition of the holding company system.

Group-Wide Supervision

The Group-Wide Supervision procedures establish guidance for lead state use in the analysis of insurance company holding systems. This includes a risk-focused approach to group regulation where specific risks that are relevant to insurance holding company structures are addressed.

- **INSURANCE HOLDING COMPANY SYSTEM ANALYSIS DOCUMENTED IN THE GROUP PROFILE SUMMARY (GPS) (LEAD STATE)**:
  - Understanding the insurance holding company system (lead state)
  - Addressing lead state analysis considerations
  - Evaluating the overall financial condition of the holding company system by completing a detailed analysis through the group's exposure to each of the nine branded risk classifications
  - Assessing corporate governance and enterprise risk management
  - Documenting material concerns or conditions in the group that affect the lead state's domestic companies
  - Performing additional procedures on key risk areas, as needed

- Sharing the results of the analysis, through the GPS, with other impacted regulators on a timely basis (i.e., by October 31 for groups with ~~entities~~insurers domiciled in multiple states)

Commented [Post2]: Edit proposed based on Vice Chair feedback

- **CORPORATE GOVERNANCE DISCLOSURE PROCEDURES**
  The *Corporate Governance Annual Disclosure Model Act* (#305) and *Corporate Governance Annual Disclosure Model Regulation* (#306) require an insurer, or an insurance group, to file a summary of an insurer or insurance group's corporate governance structure, policies and practices with the commissioner by June 1 of each calendar year. The lead state should take primary responsibility for reviewing the CGAD filing, if it is filed on a group basis, and should incorporate any takeaways or concerns into the GPS. Any concerns relevant only to a specific insurance entity in the group should be communicated to the domestic state in a timely manner.

- **OWN RISK AND SOLVENCY ASSESSMENT (ORSA) PROCEDURES**
  The *Risk Management and Own Risk and Solvency Assessment Model Act* (#505) requires insurers above a specified premium threshold, and subject to further discretion, to submit a confidential annual ORSA Summary Report.

- **FORM F PROCEDURES**
  The Form F is filed with the lead state commissioner of the insurance holding company system for every insurer subject to registration under the *Insurance Holding Company System Regulatory Act* (#440). The Form F review is to be completed by the lead state in conjunction with the review of Form B. The lead state analyst should identify the material risks within the insurance holding company system that could pose enterprise risk to the insurers in the group. Takeaways and concerns from the review should be documented in the GPS. Any concerns relevant only to a specific insurance entity in the group should be communicated to the domestic state in a timely manner.

- **PERIODIC MEETING WITH THE GROUP PROCEDURES**
  These procedures are intended to demonstrate the type of potential questions a lead state may want to consider when it conducts a periodic meeting with the group.

- **TARGETED EXAMINATION PROCEDURES**
  The targeted examination procedures provide examples of potential risk areas where the lead state may want to perform certain limited examination procedures as part of the continual risk assessment process.

LEAD STATE REPORT

The Lead State Report is located in iSite+, within Summary Reports, and is designed to improve communication and coordination between state insurance regulators. It provides a list of all insurance groups and the companies within each group, which can be sorted in various ways. The report also contains current contact information for the state's assigned insurance company analyst and the state's chief analyst, which is maintained by state insurance department staff.

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

G. Use of Independent Contractors on Multi-State Examinations

When evaluating staffing needs to schedule examinations of domestic insurers licensed in multiple states, state insurance departments may find it necessary to engage an independent contractor. An independent contractor is defined as anyone employed by the state insurance department that is outside of the department's staff. Examples of independent contractors, while not inclusive, are as follows:

- Certified Public Accountants
- Contract Examiners
- Specialists

An insurance department's decision to engage an independent contractor may arise due to, among other things, insufficient examination staff or the need to meet statutory mandates. While the foregoing circumstances may lead an insurance department to contract the services of an independent contractor, the department should consider the long term effects of not maintaining an appropriate level of qualified staff. Maintaining competent examiners on examinations and during interim periods enhances the department's ability to effectively regulate domestic insurers and foreign insurers with substantial state premium writings. Through the examination process, examiners can enhance their knowledge of state laws and regulations, various types of insurance products, investment practices, loss reserving techniques, reinsurance transactions etc., that are useful in effectively and efficiently assessing a domestic company's financial condition and results of operations. This internal expertise is particularly important in handling troubled insurance companies.

The use of independent contractors requires the involvement of the state insurance department in directing and monitoring the work performed by the independent contractor. The oversight of independent contractors is primarily the responsibility of the insurance department's designee.

The role of department designee must be filled by an individual who is certified by the Society of Financial Examiners (SOFE) as a Certified Financial Examiner (CFE) or by an individual who has substantially similar experience, qualifications and background. (Include the details in examination planning memorandum.) This individual must be employed by and conducting work solely on behalf of the State Insurance Department. In general, the department designee should have an accounting, insurance, financial analysis, financial examination, information technology (IT) and/or actuarial background, and insurance backgrounds should primarily be financial in nature. College degrees should generally focus on accounting, insurance, finance, business, risk management or actuarial science. Other professional designations and credentials may also demonstrate expertise in insurance and/or financial examinations.

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 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.

2. Standards of Examination Conclusions and Reporting

a. The insurance department's designee shall review and approve key solvency monitoring and completion documents on a timely basis, including the summary review memorandum (Exhibit AA) and evidence of interdepartmental communication of significant issues and concerns.
b. The examination results and findings shall be reviewed for reasonableness and sufficiency, and accompanying workpapers shall be reviewed for adequacy of documentation by the insurance department's designee.
c. The report shall be prepared by the insurance department in accordance with the Handbook and departmental policy.
d. The report shall be signed by the examiner-in-charge (EIC). If the EIC is an independent contractor, the report shall also be signed by the insurance department's designee.
e. The insurance department's designee shall complete the general review section of the Review and Approval Summary (Exhibit Q) to ensure an appropriate depth of review has been performed.

3. Use of a CPA on an Agreed-Upon Procedures Engagement

While not very common, the use of a CPA independent contractor in an examination may be accomplished through an "Agreed-Upon Procedures Engagement." (Only CPAs can perform an Agreed-Upon Procedures Engagement.) In addition to meeting the standards of examination planning, fieldwork, and examination reports, the following establishes guidelines for engaging a CPA to perform agreed-upon procedures.

The American Institute of Certified Public Accountants (AICPA) Statement on Standards for Attestation Engagements No. 10, *Attestation Standards: Revision and Recodification* (SSAE No. 10), sets forth the standards and provides guidance to the CPA when performing and reporting on engagements to apply agreed-upon procedures. In an agreed-upon procedures engagement, the CPA performs specific procedures on specific elements, accounts or items of a financial statement and issues a report of findings based on those procedures. The insurance department and the CPA agree upon the procedures to be performed by the CPA that the insurance department believes are appropriate. Therefore, the insurance department assumes all responsibility for the sufficiency of the procedures and the risk that those procedures might be insufficient for their purposes. Because the CPA will only report on the findings of the procedures performed, any conclusions regarding the findings, and disposition thereof, must be made by the department. Additionally, the CPA has no responsibility to determine the differences between the agreed-upon procedures to be performed and the procedures that the CPA would have determined necessary had he or she been engaged to perform another form of engagement, such as an audit under generally accepted auditing standards. The department should review SSAE No. 10, and consider the CPA's professional standards prior to engaging an accounting firm to provide this type of service.

The insurance department must attain certain standards relative to the examination report, planning and field work that are in accordance with the Handbook. These standards relate to the responsibilities of the insurance department and the utility of the examination report in achieving regulatory objectives when engaging a CPA to perform agreed-upon procedures.

4. Conflicts of Interest

Conflicts of interest may occur if an examination of a company is performed by an independent contractor who has a significant relationship with the company, its affiliates, or their management (financial or non-financial) that may impair in fact, or appearance, the independent contractor's independence. To evaluate any such conflicts of interest, the insurance department should request a disclosure letter from the independent contractor regarding their past, present or planned relationships, both financial and non-financial, with the examined company or its affiliates. The disclosure letter should discuss the nature of the services provided by the independent contractor and the amount of fees paid to the ~~CPA~~ contractor by the company over the preceding five years.

Determining whether a potential conflict of interest exists is a matter of considerable judgment. As independent contractors could provide many different types of services (e.g., accounting, auditing, actuarial, management and tax consulting), it will be necessary to evaluate the nature of services provided and the amount of fees involved when determining whether a potential conflict of interest exists.

Additionally, if relevant, the insurance department should request and review information provided on all relationships between the contractor, the contractor's firm or any affiliates of the firm with entities that are regulated by the department for which the anticipated services of the contractor may have some impact, directly or indirectly, on the department's oversight of such entities. To the extent that other services are potentially impacted, the department should request and review information on controls put in place by the contractor to ensure that potential conflicts do not exist and/or are not created through assignment of examination work.

5. Confidentiality Protections

The state insurance department should ensure that adequate confidentiality protections are incorporated into contracts with independent contractors to ensure that confidential and proprietary information of the insurer/group shared with the contractor for purposes of conducting financial examination work is adequately protected in accordance with state law and recommended best practices. Such contracts should indicate that any non-public or proprietary information or data to which the contractor has access during financial examination work on behalf of the state insurance department may not be utilized to benefit consulting/advisory engagements for the contractor's other clients or otherwise to promote the contractor's business. In certain situations, state insurance department might be required to include specific confidentiality language in the contract and/or inform the insurer prior to sharing confidential and proprietary information (e.g., ORSA, Corporate Governance Annual Disclosure) with the independent contractor. As such, state insurance departments are encouraged to review their state requirements before sharing confidential information with an independent contractor.

6. Security and Data Governance

The state insurance department should ensure that adequate security and data governance practices are in place at the independent contractor to keep all information and data reviewed or obtained during the engagement with the department confidential and maintained in a secure environment with access limited only to listed authorized personnel. Such practices should include an obligation to report any breach or unauthorized access or disclosure to the department and should include the use of secure file transfer protocol for delivering information and employ best practices for encryption and/or access to the information.

Commented [Post1]: Edits proposed in response to IP comments. Intent is for consistency with FAH.

7. Maintenance of Workpapers

The insurance department should maintain, at a minimum, a complete ~~photocopied~~ set of the ~~CPA's~~ contractor's original workpapers.

~~6~~8. Independent Contractors' Immunity Privileges

When hiring independent contractors to perform all or portions of a state insurance examination, the state insurance department should consider the following items related to the independent contractor's immunity prior to finalizing an agreement.

- Review the NAIC *Model Law on Examinations* (#390), Section 8 to determine if your state has adopted these provisions in its statutes. If your state has not adopted Model #390, confirm if it has adopted similar language which grants immunity to any examiner appointed by a commissioner.
- Determine if there are any relevant court decisions or opinions, which hold that an examiner appointed by the commissioner is granted immunity from liability in the performance of his/her duties.
- Verify if independent contractors in your state are required to carry liability insurance coverage for work performed. Determine if your state provides insurance coverage to these independent contractors in the performance of their duties.

~~7~~9. Controlling Exam Costs when Utilizing Independent Contractors

It is important to keep in mind that the use of independent contractors can lead to higher examination costs. It is the regulator's responsibility to appoint and monitor the independent contractor, and it is the insurer's responsibility to cooperate with the independent contractor and provide appropriate input to facilitate an efficient examination process. The insurer may provide factual input to the regulator based on observations of the independent contractor's work. High-level company monitoring of the examination process and ongoing two-way communication of problems on the examination (related to the cooperation of the insurer or the performance of the examination) can help ensure the effective use of independent contractors. If state legislation permits and circumstances are warranted, it may benefit the regulator to consider the following procurement procedures in order to control costs when utilizing an independent contractor.

a. The regulator should have minimum qualification standards that the independent contractor should meet in order to be considered in the procurement process. The independent contractor should have the following:

   - Practical experience with the type of work that is out for bid;
   - Qualified personnel; and
   - Demonstrable success on prior contract examinations.

b. The regulator should consider having a meeting with all qualified vendors (independent contractors) and the insurer to further explain, clarify, or identify areas of concern. This meeting should address the following:

   - A detailed description/specification of the work to be performed in terms of required outcomes. Specifications should be written to encourage, not discourage, competition consistent with seeking overall economy for the purpose intended. The goal is to invite maximum reasonable competition;
   - Concerns of the insurer, independent contractor and the department of insurance; and
   - Time frame of the bidding process.

c. The potential independent contractor should describe their organizational and staff experience as well as past experience, which should be described in sufficient detail to demonstrate their ability to perform the functions outlined by the department. For long-term projects, the independent contractor should document their experience, capability, and commitment to perform project management functions.

d. The independent contractor should provide a minimum of three references who may be contacted where services similar in scope to the requirements outlined by the department have been provided. The state department should consider the independent contractor's experience with other state insurance departments.

e. Prior to selecting the independent contractor, the regulator should consider at least three competitive bids.

f. The most responsive and responsible independent contractor whose bid reflects the lowest price should be considered. "Responsible" means that the vendor has the capability, integrity, and reliability to provide the services needed. Being "responsive" means that the bid conforms in all material respects to the requirements outlined by the department.

Various types of contracts exist and each type of contract should be considered by the regulator when utilizing independent contractors. Fixed fee contacts and cost-reimbursement type contracts are two common types of contracts. Fixed fee contracts are contracts for a set amount, regardless of the expenses or hours incurred by the independent contractor. Under this scenario, the independent contractor is fully responsible for performance costs and enjoys (or suffers) resulting profits (or losses) based on the efficiency and effectiveness of their examination progress. Fixed fee contracts are typically appropriate when the work to be performed by the independent contractor can be described clearly and the regulator can write clear and detailed specifications for how the work is to be done. If a fixed fee contract is not chosen, the regulator may use a cost-reimbursement type contract. In this type of contract, the department agrees to compensate the independent contractor at a fixed hourly rate plus compensation for reimbursable expenses. If this type of contract is used, the regulator should strongly consider making it a three-party contract between the state department, the independent contractor and the insurer.

If a fixed fee contract is used, independent contractor travel expenses are irrelevant to the regulator. If a contract that allows for cost reimbursement is utilized, the regulator should consider the extent of the independent contractor's travel expenses. It is recommended that the regulator monitor the independent contractor's travel expenses. The regulator should consider the recommended per diem rates for lodging, meals and incidentals set forth within Section 1, Part II, D of this Handbook (this is also available on the NAIC Web site).

The above mentioned guidance, as it relates to procurement, contracts and travel expenses, combined with continued monitoring of the independent contractor's work may result in significant cost decreases. It is encouraged that the time budget be communicated to the insurer, however, final approval of the budget should reside with the insurance department and the work of the independent contractor should be directed by the state regulator. Consider holding frequent status meetings with the independent contractor to ensure that the adequacy and timeliness of the work being performed is meeting the department's expectations. The development of a detailed time budget for the independent contractor will allow the insurance department and the insurer to compare the actual work performed with expectations. The time budget should estimate the time to complete examination sections, which typically are annual statement line items, system processes, related controls or the company background. The independent contractor should submit time budgets to the state insurance department on at least a monthly basis, or as often as a detailed time and expense billing report is required to be submitted. The detailed time budget should also include an estimated date of completion for all fieldwork. If any action, or lack of action, by the insurer causes the independent contractor's hours to significantly increase (i.e., a greater than 10% increase in the budgeted time for a specific examination area), the independent contractor should immediately communicate this to the state department, who would then contact the insurer. This same communication process should take place if the independent contractor becomes aware of any material transactions that took place subsequent to the balance sheet date.

NATIONAL ASSOCIATION OF INSURANCE COMMISSIONERS

MEMORANDUM

TO: Amy Malm, Chair of the Risk-Focused Surveillance (E) Working Group

FROM: Diana Sherman, Facilitator of the Chief Financial Regulator Forum

DATE: November 16, 2024

RE: Reciprocal Attorney in Fact Compensation

During its November 16, 2024, meeting, the Chief Financial Regulator Forum discussed the recent increase in the number of reciprocal exchanges being formed and challenges in assessing the fairness and reasonableness of attorney-in-fact fees being charged to the newly formed reciprocals.

The fee structure for management services is often based on a percentage of gross premiums written, which may be difficult to evaluate for fairness/reasonableness by comparing against market rates or obtaining detail on the costs of services provided. In addition, by basing the management service fees on a percentage of premium volume, there is the potential incentive for the attorney-in-fact to increase its fee revenue by underpricing or accepting risk that may be above its typical underwriting guidelines. Management service fees are also often included in the power of attorney agreement, as opposed to a separate service agreement, which can make the fees less transparent.

Given these potential issues and concerns, the Chief Financial Regulator Forum is referring this topic to the Risk-Focused Surveillance (E) Working Group to consider the development of additional guidance for use in reviewing service agreements between a reciprocal exchange and its attorney-in-fact.

If there are any questions regarding the referral, please contact either me or NAIC staff (Bruce Jenson at *bjenson@naic.org*) for clarification. Thank you for your consideration of this important issue.

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