The ComFrame Financial Examination Drafting Group has developed proposed additions to the NAIC’s Financial Condition Examiners Handbook (FCEH) that incorporate key elements of the IAIS’ Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame) deemed appropriate for the U.S. system of solvency regulation. The Drafting Group consists of financial regulators from California, Connecticut, Missouri, and Nebraska that are actively involved in group supervision efforts. Additionally, the Drafting Group closely monitored the work of the Financial Analysis and ORSA ComFrame drafting groups to ensure that proposed revisions are consistent and complementary.

The Drafting Group recommends that the Working Group expose the proposed additions for a public comment period and encourage the Financial Examiners Handbook (E) Technical Group to monitor and participate in the comment period to ensure that all stakeholders are notified of the proposed revisions. In addition, after any comments received are appropriately addressed, the Drafting Group recommends that the proposed revisions be referred over to the Financial Examiners Handbook (E) Technical Group for consideration of adoption into the 2023 FCEH.

A summary of the proposed additions, including references to their associated ComFrame elements, is provided below:

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<th>ICP</th>
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| ICP 5 | Corporate governance framework at IAIG, including suitability of key individuals at IAIG | FCEH Section 2, Part I – Understanding the Corporate Governance Function  
   • Consideration of obtaining governance information at Head of IAIG level (i.e., CGAD, biographical affidavits) and conducting review and assessment procedures at that level, when applicable |
| ICP 7 | | FCEH Section 4, Exhibit E – Audit Review Procedures  
   • Guidance clarifying that Internal Audit members should not have other operational, risk management, or accounting responsibilities to be considered independent. |
| | | FCEH Section 4, Exhibit M – Corporate Governance Assessment  
   • Additional section including inquiries/procedures applicable to IAIGs |
| | | FCEH Section 4, Exhibit Y – Examination Interviews  
   • Additional guidance indicating that interviews may be necessary at the Head of the IAIG, when applicable |
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<th>ICP</th>
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| ICP 8 | Risk management framework at IAIG, including groupwide considerations for internal control systems; internal audit, compliance, and actuarial functions; and outsourcing activities/functions. Consideration of policies and practices for relevant key activities:  
- Investments  
- Claims Management  
- Reinsurance  
- Actuarial Function  
- Capital Management | FCEH Section I, Part III.F – Outsourcing Critical Functions  
- Additional guidance to evaluate a company’s due diligence prior to entering into new, material outsourcing agreements.  
FCEH Section I, Part XI – Reviewing and Utilizing the ORSA  
FCEH Section IV – Exhibit M: Corporate Governance Assessment  
- Additional section including inquiries/procedures applicable to IAIGs  
FCEH Section III – Examination Repositories  
- Added statement to respective examination repositories to indicate that some or all risks within the key activity could be utilized to address relevant ComFrame considerations, and therefore procedures may need to be performed at the Head of the IAIG. When only some risks are deemed applicable, these are identified with the † symbol. |
| ICP 9 | Group-wide risk assessment and inspections            | FCEH Section I-I.F - Coordinated Examinations of Internationally Active Insurance Groups  
- Narrative guidance and procedures reference the fact that some group-wide assessments are more appropriately conducted through coordinated onsite examinations, when relevant  
FCEH Section 4 – Exhibit AA: Summary Review Memorandum  
- For coordinated examinations of IAIGs or other groups (as deemed appropriate), documentation on the SRM may need to be expanded to include groupwide conclusions |
| ICP 23 | IAIG and Head of IAIG determination                  | FCEH Section I-I.F - Coordinated Examinations of Internationally Active Insurance Groups  
- Added guidance from ComFrame and Model Act on IAIG determination into section for background purposes  
- Added reference to the Financial Analysis Handbook as the primary source for related information and procedures for identifying the IAIG and Head of the IAIG. |
I. EXAMINATION OVERVIEW

This section of the Handbook addresses the following subjects:

A. Exam Classifications Defined
B. General Procedures for Scheduling an Examination
C. Coordinating Examinations of Multi-State Insurers
D. Coordination of Holding Company Group Exams
E. Review and Reliance on Another State’s Workpapers
F. Examinations of Internationally Active Insurance Groups
   G. Examinations of Underwriting Pools, Syndicates and Associations
   H. Special Financial Condition (E) Committee Examinations
   I. Limited-Scope Examinations
   J. Interim Work

D. Coordination of Holding Company Group Exams

A coordinated group examination should attempt to be a comprehensive and simultaneous examination of insurance entities in a holding company group, which may be domiciled in multiple states. The phrases “holding company group” and “group” are used interchangeably throughout this section and are meant to include insurers that meet the definition for inclusion in an “insurance holding company system” as defined in the Insurance Holding Company System Regulatory Act (§440), as well as entities that do not belong to the same group code, but may share common systems, and are tied together through large transactions or could otherwise benefit from being examined together. Coordination among the states should include the timing, scope and extent of examination procedures, utilization of specialists (e.g., information systems and actuarial) and their work products, and allocation of work among examiners. This coordination promotes communication among the states and the efficient use of resources, provides an avenue for multiple perspectives to be shared, and minimizes the duplication of work.

Exam coordination among insurers of a group or holding company system is critical for effective solvency regulation. When examinations are conducted on a group of insurers, the goal is to gain efficiencies and prevent duplication of testing wherever possible. Group examinations not only provide information on each insurer individually, but also provide an avenue for regulators to understand and evaluate the risks of the holding company group as a whole. Under Model §440, regulators have the authority to examine “any insurer registered under Section 4 and its affiliates to ascertain the financial condition of the insurer, including the enterprise risk to the insurer by the ultimate controlling party, or by any entity or combination of entities within the insurance holding company system, or by the insurance holding company system on a consolidated basis.” Therefore, in conducting a coordinated group exam, the lead state or exam facilitator should work with the assigned financial analyst to identify and address any significant concerns at the group level with the potential to threaten the solvency of the insurers being examined. In this situation, a group examination report may be issued by the lead state, but does not reduce the need to obtain evidence about the solvency of each insurer or eliminate requirements for individual examination reports.

States should coordinate examinations of all types of insurers operating in holding company groups when possible, including health insurers that operate primarily as health maintenance organizations (HMOs). Even though these organizations are often composed of single-state entities, they could still share processes, controls and decision-making that might be more efficiently reviewed through a coordinated group examination.

When conducting a coordinated examination, states participating in the examination will often have access to information that is considered sensitive and/or confidential. The NAIC Financial Regulation Standards and Accreditation Program requires that the states allow for the sharing of otherwise confidential information and administrative or judicial orders to other state regulatory officials, providing that those officials are required, under their law, to maintain its confidentiality. The NAIC Master Information Sharing and Confidentiality Agreement allows for signatory states to share confidential information with another signatory state that can demonstrate that its laws will protect the confidentiality of the shared information.
information. This agreement is designed to eliminate the need for states to sign numerous multi-state agreements on a myriad of regulatory subjects.

Before, during and after a group examination, the Lead State, Exam Facilitator and any other regulators that have domestics in the group—whether participating in the group exam or not—should be prepared to discuss relevant information with the NAIC Financial Examiners Coordination (E) Working Group. This information could include, but is not limited to, scheduling a group exam, the progress of a group exam, and why coordination did or did not occur between states for a particular group.

**Determining the Lead State and Subgroups of Companies**

Every insurance holding company system has individual characteristics that make it unique. Therefore, an evaluation of traits is required to determine how examinations for the group should be coordinated and which individual state, known as the Lead State, should assume the leadership role in coordinating group examinations. The Lead State is charged with the coordination of all financial exams for the holding company group, as well as other regulatory solvency monitoring activities (e.g., group supervision, including holding company analysis; group profile summary (GPS); assessments of the group’s corporate governance and enterprise risk management (ERM) functions, etc.) as defined within the Financial Analysis Handbook.

In most situations to date, the Lead State has emerged by mutual agreement (i.e., self-initiative on its part and recognition by other states), generally as a result of the organizational structure of the group or as a result of the domicile of primary corporate and operational offices. The input of domestic regulators within the group also plays critical role in determining which state should be chosen to fulfill the role of the Lead State. Other factors that may be considered when determining the Lead State are:

- State with the largest number of domestic insurance companies in the group.
- State of large or largest premium volume or exposure.
- Domiciliary state of top-tiered insurance company in an insurance holding company system.
- Physical location of the main corporate offices or largest operational offices of the group.
- Expertise in the area of concern and experience of staff in like situations.
- State whose regulatory requirements have driven the design of the organization’s infrastructure.

Because each group has its own unique characteristics, as do the companies within each group, it might be appropriate to separate the group into smaller factions and identify an Exam Facilitator for each subgroup examination. In order to gather information to make this decision and to assist in planning the coordinated examination, the Lead State might review group information contained in the Lead State Summary Report on iSite+, as well as request that holding company group personnel provide information to be considered in grouping companies within the holding company group for financial examinations. At a minimum, the information provided should include the topics of corporate governance of the group, risk management and decision-making, key functional activities and processes, lines of business, and computer systems. This information request is also included in Exhibit Z, Part One.

**Responsibilities of the Lead State**

The primary purpose of the Lead State is to promote the coordination of exams for all entities within the group. In achieving this goal, the Lead State should fulfill the following responsibilities:

1. **Develop, maintain, and communicate group coordination plan:**
   The Lead State should actively encourage all states within the group to participate in coordinated group examinations when possible. To help facilitate participation by all states, the Lead State should develop, maintain, and communicate a group coordination plan, using Exhibit Z, Part Two-A, or a similar document. The group coordination plan may include, but is not limited to, information about potential subgroups, anticipated examination schedule, primary location of fieldwork, etc. The Lead State should also consider whether other entities that do not share a group code should be involved in the coordinated examination. For example, there may be entities that share services or other financial relationships with the entities in the group but are not under common control or do not
have an assigned NAIC cocodes; i.e., captive insurance companies or other risk-bearing entities, warranties, etc. Consideration of whether these entities may benefit from involvement and/or awareness of the coordinated examination should be documented in the coordination plan, when appropriate. Such a plan would allow ample time for the states to make the necessary arrangements to participate in future coordinated efforts.

The frequency at which the coordination plan is updated and communicated to domestic regulators within the group may vary based on the size and complexity of the group. At a minimum, the group coordination plan should be updated and communicated at least four months prior to the “as-of” date of an expected examination. However, updates should be made and appropriately communicated based on relevant changes to the group and/or examination schedule.

The Lead State should be prepared to discuss relevant information pertaining to the group coordination plan and the status of coordination efforts with the NAIC Financial Examiners Coordination (E) Working Group as requested. If selected, the Lead State would be required to present such information to the Financial Examiners Coordination (E) Working Group at an NAIC national meeting.

2. Monitor the status of examination activities:
The Lead State is expected to be aware of the progress of all ongoing exams performed on all entities within the group. The Lead State should also be aware of the significant results of all recently completed exams. If consistent problems are identified during examination efforts, the Lead State may need to become involved in addressing the issues at the group level.

3. Identify subgroups, when appropriate:
In situations where it is not feasible for all legal entities within a group to be examined at one time, it is the Lead State’s responsibility to determine subgroups for ongoing examination purposes. The Lead State should consider company input—i.e., Exhibit Z, Part One—as well as input from other domestic regulators within the group when making this decision. The use of subgroups should be reflected in the group coordination plan; i.e., Exhibit Z, Part Two-A.

4. Schedule the coordinated examination:
For each holding company group, consideration should be given to the priority of each entity within the group when determining the frequency at which group examinations should be performed. The Lead State should obtain input from all of the key domestic regulators within a group (or subset of companies) before determining the “as-of” date for the next examination. This input may be obtained through the use of a supervisory college, conference calls conducted through the financial analysis process, or other meetings to discuss the financial regulation of a particular group.

In addition to basing the frequency of full-scope group examinations on the financial strength of the group, regulators should consider performing limited-scope exams when specific concerns arise with the holding company group and/or conducting interim work to address areas considered inherently risky. Whenever conclusions are reached regarding the scheduling of full or limited-scope group examinations, prompt notification should be provided to all states with domestics in the group (or subset of companies) to enable all domestic states the opportunity to participate in the group examination.

The group examination schedule should not preempt consideration of a state’s prioritization schedule or postpone examinations of troubled companies, nor should it interfere with the state’s obligation to conduct a full scope examination of its domestic insurance companies in accordance with state statutes. However, states should remain flexible and attempt to coordinate, when appropriate, to ensure an effective and efficient examination. In some circumstances, this may necessitate accelerating the examination schedule of one or multiple legal entities in the group in order to synchronize the examination schedule.

5. Notify others of an upcoming examination (informal notification):
The Lead State should notify other states that have domestics in the group of the exam well in advance of significant planning work to allow them the opportunity to participate on the examination. Advance notification should also
be extended to the companies that will be examined as part of the group examination to allow them to prepare. The informal notification to the other state regulators and the companies should occur at least six months prior to the “as-of” date (e.g., 12/31/20xx) of the examination.

6. **Call group examination(s) in FEETS (formal notification):**
   The chief examiner of the Lead State or designee is responsible for placing the group examination call in the Financial Exam Electronic Tracking System (FEETS) to simultaneously examine the entire group (or subset) of insurance companies involved in an insurance holding company group. When calling the group examination(s), the Lead State should indicate (by “inviting”) which legal entities in the group will be examined together.

   - **Timing of the group exam call:**
     In most circumstances, the formal calling of the group examination in FEETS should occur at least 90 days before the anticipated start date of the group examination by the Lead State. The timing difference between the informal notification and the calling in FEETS allows the Lead State time to determine specific attributes of the group exam, such as the primary contact person and the anticipated start date of the exam that may not be known six months before the “as-of” date.

     If an exam is scheduled due to specific concerns with a group of companies that do not allow the exam to be called in FEETS at least 90 days before the anticipated start date, the Lead State should document an explanation for inclusion in the group exam workpapers and notify other state insurance regulators as soon as possible.

   - **Assign Exam Facilitator (if applicable):**
     In many situations, it is expected that the Lead State will assume the Exam Facilitator role itself to conduct and lead the group examination. However, in situations where subgroups have been formed that don’t involve the Lead State, it is anticipated that the Exam Facilitator role will be delegated to an accredited state within the group. If the responsibility is delegated, the accepting state would then assume the responsibilities associated with conducting that group examination. The role of Exam Facilitator is typically temporary in nature because it pertains only to a specific group examination being performed; once that exam has been closed, the need for an Exam Facilitator is no longer present and any assumed responsibilities remit back to the Lead State (if they were delegated).

     The selection of the Exam Facilitator can be accomplished through a review of the documentation provided by the holding company group personnel and through discussions with the impacted states. The regulated entities should also be allowed to provide input on the Exam Facilitator determination process where appropriate. The designated contact person should be the chief examiner, or equivalent, for the Exam Facilitator of each group exam.

     Due to the design of the application, the Lead State will always call the exam in FEETS. If a different state has been delegated the responsibilities of the Exam Facilitator, the Lead State must designate the Exam Facilitator in the FEETS group exam call. Once the Exam Facilitator has been assigned in FEETS, that state will be able to make changes to the assigned group exam, including close the group exam upon completion.

   - **Other considerations:**
     It is recommended that all group examinations be called in FEETS regardless of what type(s) of insurers are being examined. For example, if a group exam is being conducted for a group of HMOs that are all single-state entities, the group exam should still be called in FEETS for informational and tracking purposes.

     Additionally, when calling a group exam in FEETS, only entities that share an NAIC group code are pre-populated. However, there may be other entities that should be considered for inclusion in the group exam. This may include affiliated companies that do not have an NAIC code; i.e., captive insurance companies or other risk-bearing entities, warranties, etc. It may also include unaffiliated entities that have significant
influence or could materially impact insurers in the group (e.g., a company that has a significant reinsurance relationship with a company belonging to the holding company group).

7. **Maintain communication with the group personnel:**
   The Lead State should serve as the primary regulatory contact with top management of the group on an ongoing basis regarding overall coordination activities for companies within the group. Additionally, the Lead State is responsible for elevating significant solvency concerns to top management of the group when issues are unable to be resolved at lower levels within the group.

8. **Act as the Exam Facilitator, as deemed appropriate:**
   As noted above, unless otherwise assigned, the Lead State will also act as the Exam Facilitator for coordinated examinations of companies within the group. The responsibilities associated with this role are outlined in the next section.

**Responsibilities of the Exam Facilitator**

The role of Exam Facilitator may vary from exam to exam; however, certain responsibilities assigned to this role are shown below. As discussed in the “Review and Reliance on Another State’s Workpapers” section following this section, the Exam Facilitator is responsible for the overall quality of work performed in completion of a coordinated group examination. Additionally, the Exam Facilitator for all examinations must be an accredited state.

1. **Develop an examination team:**
   Once it has been decided that a coordinated group exam will be conducted, the Exam Facilitator should work with the states in the group to determine the necessary staffing requirements for the specific examination at hand, including which states within the group plan to have a direct role in the examination and whether additional specialists are needed.

   The Exam Facilitator should contact the participating states to establish points of contact by name/role, determine the amount of interest in participating in the coordinated examination, and establish lines of communication with participating states. Preferably, the Exam Facilitator should designate a primary and a back-up point of contact for communications with the organization under review, with other state regulators and stakeholders. At a minimum, information for the primary contact person should be provided for the group exam in FEETS.

   While developing the exam team for a group examination, the Exam Facilitator should coordinate and utilize any available resources (within the group or contracted) that are necessary and appropriate to complete an effective and efficient examination. These may include, but are not limited to, financial analysts, financial or market conduct examiners, IT examiners, actuaries, legal counsel, rate and form experts, or valuation experts. Consideration should be given to the areas of expertise needed to complete the examination. If possible, states participating in the group exam should consider utilizing the same staffing resources when efficient to do so. For example, it may be efficient to utilize the work of one actuary who could become familiar with the general processes utilized by the group of insurers instead of contracting several different actuaries who would all have to familiarize themselves with the same processes.

2. **Seek input from other regulators:**
   During the planning stages of an exam, the Exam Facilitator should request input from other regulators regarding any areas of concern that should be addressed during the group exam. Input should be requested from any states with domestics in the group or subgroup, as applicable, even if a state is unable to participate in the coordinated exam. This responsibility includes obtaining input from each state regarding the key activities and inherent risks it anticipates for each of its domestic companies. Consistent with the guidance in Phase 1, identification of key activities and risks should primarily be determined by areas that represent significant solvency concerns. The Exam Facilitator should also contact regulators of holding company groups that include an entity or entities that are at least in part regulated outside the state insurance regulatory structure for items to consider or address during the examination.
Once the Exam Facilitator has accumulated information from each regulator, in addition to information related to its own domestics, it should determine which key activities/inherent risks will and will not be addressed as part of the group examination and notify the other state insurance regulators. Testing performed by participating states in areas deemed insignificant to the overall group examination are considered state-specific procedures and, therefore, the oversight of such work is outside of the Exam Facilitator’s responsibility.

3. Delegate responsibilities among the examination team:
   Once the examination team has been established, the Exam Facilitator should clearly delegate responsibilities between itself and any participating examiners, with input from participating states. The Exam Facilitator should develop a process to manage information requests going to holding company group personnel to prevent redundancy. The Exam Facilitator should also attempt to coordinate the timing of work that will be performed by all states participating on the group exam to the extent possible. This includes organizing a review of shared processes and controls and determining which state(s) are responsible for which key activities and processes. When delegating responsibilities, the Exam Facilitator should consider the resources needed and available for the task among the participating states as well as the expertise and ability to supervise personnel as necessary. Although certain tasks may be delegated among participating states, the Exam Facilitator remains responsible for the overall quality of work performed in completion of a coordinated group examination and should review such work accordingly.

One of those responsibilities includes meeting with internal and external auditors. The Exam Facilitator should ensure completion of Exhibit E – Audit Review Procedures for the group examination. The Exam Facilitator should also coordinate the communication of obtaining and reviewing any relevant auditor workpapers to prevent redundancy between states.

In Phase 5, detail testing may be necessary for any particular identified risk. With input from the participating states, the Exam Facilitator should determine whether detail testing will be performed as part of the group examination or if the testing will be performed separately by each domestic regulator. Regardless of which method is used, if detail testing will involve substantive testing of individual account balances, the testing should be applied at an individual company level based on the residual risks determined during the group exam.

When selecting what substantive testing should be performed, the materiality levels for each individual company should be utilized so that exam evidence will be obtained for each insurer based on its dollar value. However, if detail testing will consist of testing the attributes (or accept/reject testing) of underlying data utilized in other calculations (e.g., loss reserves, unearned premiums), the testing may be performed at the group level because the examiner is testing the occurrence of a particular attribute in a population subject to the same control processes. For pooling arrangements, see the “Exceptions to Consider Related to Coordinating Group Exams” section below.

4. Establish lines of communication with top management in the group:
   The Exam Facilitator should ensure that regular and candid discussions occur with top management of the insurance companies regarding the results of the ongoing group examination. A structure for obtaining updated information from company management regarding the ongoing exam should also be established. If significant solvency concerns arise that are unable to be resolved by the Exam Facilitator, the issue should be raised to the Lead State, if different, to address with top management of the group.

5. Obtain a thorough understanding of the companies being examined:
   The Exam Facilitator should obtain as much insight as possible about the group/subgroup when leading a coordinated group exam effort. To gain this understanding, the Exam Facilitator should focus on the holding company, or ultimate controlling entity, and subsequently on its underlying subsidiaries that will be included in the group exam. The Exam Facilitator should also take the primary role in obtaining and reviewing analysis work pertaining to the group/subgroup in preparation for the group exam by working with the individual domestic states.

6. Coordinate and conduct C-level interviews:
   The Exam Facilitator should perform interviews of the upper-level management and members of the board, and its committees, at the level at which oversight and management of the group’s primary insurance activities are
performed. Participating states may provide questions to the Exam Facilitator that they would like asked during interviews. These states may also participate in the interviews in limited situations when deemed appropriate. These interviews should be conducted in-person if possible. When these interviews are completed, the information should be distributed and shared among regulators as necessary to prevent unnecessary duplication of efforts. When subgroups are utilized, the Exam Facilitator of the subgroup should consult with the Lead State to determine whether a corporate governance assessment has been performed at the holding company level and if it would be appropriate to leverage at the subgroup level.

7. **Share information with participating states during the group exam:**
   Procedures should be established regarding how information will be shared, including ensuring that all participating states have real-time access to the information. This step is critical to establish the Exam Facilitator as a true “facilitator” by supplying the states and other functional regulators with the appropriate information. This can be accomplished through periodic status meetings—i.e., monthly—among the participating states and/or verbal or written updates from the Exam Facilitator to the broader group of state insurance regulators.

   Real-time access of workpapers could also be accomplished through the use of a shared hosting environment or other tools available to individual states. When possible, the examination team should conduct work within the same examination file to allow for enhanced collaboration among exam participants. Utilizing the same examination file may also reduce the possibility of duplicative documentation and enable other participants to observe and review work in real time. Insurance departments should develop methods to receive, as well as to communicate, pertinent information regarding holding companies and insurance groups to other affected states and other functional regulators.

8. **Review the work performed by participating states:**
   As noted previously, the Exam Facilitator is responsible for the overall quality of work performed in completion of a coordinated examination. Therefore, the Exam Facilitator should perform a sufficient level of review of work completed by participating states on behalf of the coordinated exam effort to gain comfort that the quality of work meets the examination objectives and the Exam Facilitator’s expectations. When determining the extent of review, the Exam Facilitator should consider its comfort and experience with the quality of work performed by each participating state.

9. **Promote consistency in examination deliverables:**
   The Exam Facilitator should communicate with all states involved in the coordinated effort to promote consistency of information shared in management letters and examination reports. If the Exam Facilitator determines that examination deliverables will include reporting at the group level—i.e., a group management letter—in addition to the legal entity examination deliverables, the Exam Facilitator should consult with the Lead State (if different) and other states participating in the examination to determine which results and observations will be included. Additional guidance for preparing management letters, including considerations for determining the significance and severity of findings or comments to be communicated as well as the level at which corrective measures can be taken, can be found in Section 2-7.

10. **Distribute information to participating states and other functional regulators, when applicable:**
    In limited situations, participating states may opt to work in a standalone examination file that is separate from the coordinated group examination file. If this happens, once the work of the group is completed, the Exam Facilitator is required to provide the participating state(s) with an electronic copy of the corresponding workpapers related to the group examination for inclusion in the workpapers for their respective individual company exams. The Exam Facilitator should also communicate the completion of the group exam procedures to the holding company group personnel indicate that any work after that point is being performed by individual states for their individual domestics.

11. **Resolve any disputes or disagreements regarding the group examination:**
    The Exam Facilitator should settle any disagreements among participating states prior to finalizing the coordinated examination, when possible. If the Exam Facilitator is unable to resolve the issue at hand, it should defer the issue
to the Lead State (if different than the Exam Facilitator). If the issue is not able to be resolved at that level, the Financial Examiners Coordination (E) Working Group can be consulted for timely resolution.

12. **Hold an exit conference with the participating states:**
Once the group exam work is completed, the Exam Facilitator should host an exit conference to discuss the overall results of the group exam and possible steps for regulating the holding company group in the future. The Lead State should be invited to participate in the exit conference if it was not already participating in the examination. During this meeting, the Lead State and the Exam Facilitator should discuss with the participating states when the next group exam should be scheduled and update the group coordination plan accordingly. If the regulators have difficulty coming to an agreement regarding the next group exam date, they should consult the Financial Examiners Coordination (E) Working Group for input and assistance.

13. **Close the group examination in FEETS:**
Upon the completion of the group examination, the Exam Facilitator should ensure that each participating state has linked its individual examination(s) to the group examination in FEETS. Once work in support of the coordinated group exam has been completed and each participating state has linked its individual examination(s) to the group exam, the Exam Facilitator should close the group examination. Each domestic state is responsible for closing its individual examination(s) upon completion, as noted within the “Responsibilities of States Participating in a Coordinated Exam” section below.

**Responsibilities of States Participating in a Coordinated Exam**

In general, the role of each participating state that is not the Exam Facilitator is to pledge some level of cooperation and coordination with other states and to give support and recognition to the Exam Facilitator. In order to be considered a participating state, a state must demonstrate active involvement throughout the duration of the coordinated examination. This can be accomplished in a number of specific ways, as described below:

**Indicate willingness to participate in the coordinated examination**

1) **Respond to informal and formal notifications of anticipated coordinated exam:**
When planning a coordinated examination, the Lead State (or Exam Facilitator, if different) will typically issue an informal notification of an upcoming examination several months in advance of the planned examination “as-of” date. Participating states are encouraged to respond to the informal notification in a timely manner to allow the Lead State/Exam Facilitator to adequately plan for the coordinated examination. Each participating state is responsible when attempting to coordinate and should consider the long-term benefits of coordination.

The Lead State (or Exam Facilitator, if different) will also issue a formal notification (sent via email by FEETS) of an upcoming coordinated examination at least 90 days prior to the examination “as-of” date. The participating state(s) should respond to the Exam Facilitator within 30 days of receiving the email notification regarding the calling of a group examination.

Note: If a state plans to examine a legal entity that belongs to a holding company group, it should first contact the Lead State to determine whether a coordinated examination is planned or should be considered.

2) **Call individual exam(s) in FEETS and link to the group exam:**
If the state(s) plan to participate in the coordinated examination, it should call an individual exam in FEETS for each domestic legal entity that will be examined as part of the coordinated examination. Each applicable individual examination should also be linked to the group examination in FEETS.

**Participation in exam planning**

3) **Provide input to the Exam Facilitator:**
During the planning phases, the participating state(s) should communicate key activities, inherent risks or other areas of concern for each domestic company that the participating state(s) would like to be addressed during the
group exam. The participating state(s) should also provide an overview of any state-specific procedures—i.e., required compliance testing—the participating state plans to perform.

Consistent with the guidance in Phase 1, identification of key activities and risks should primarily be determined by areas that represent significant solvency concerns. The states should work with the Exam Facilitator to determine which risks will and will not be addressed as part of the group examination. This information should help the state in determining whether additional risks will need to be addressed outside of the group examination efforts.

Testing performed by participating state(s) in areas deemed insignificant to the overall group examination are considered state-specific procedures and, therefore, the quality of such work is the responsibility of the participating state.

Active involvement in the planning phases of the exam may include documenting correspondence with the Exam Facilitator and other participating states, reviewing and signing off on the planning memo, participating in the discussion of risk identification, etc.

4) **Coordinate the use of examination resources:**
The participating state(s) should provide resources to assist the Exam Facilitator and other states throughout the group examination process as requested. The participating state(s) should coordinate the use of contracted examiners and specialists, when possible.

5) **Coordinate information requests with the Exam Facilitator:**
General communication on behalf of the group exam should be discussed with the Exam Facilitator prior to contacting company personnel to prevent duplication, if possible. This includes any information requests being sent as part of the group examination.

6) **Consider interviewing individuals at the legal-entity level:**
The participating state(s) should provide the Exam Facilitator with interview questions to cover during C-Level interviews performed for the coordinated group exam, if any. The participating state(s) may also consider conducting interviews with individuals at the legal-entity level, if deemed necessary (e.g., to address matters specific to the legal entity that were not addressed through the group C-Level interviews).

**Completion of test work and other responsibilities**

7) **Complete delegated group responsibilities:**
The participating state(s) are expected to complete group responsibilities delegated by the Exam Facilitator to the satisfaction of the Exam Facilitator, which may include:
   o Completing assigned testing.
   o Addressing feedback provided by the Exam Facilitator.
   o Performing detail reviews of test work completed by its own staff.
   o Other responsibilities as communicated by the Exam Facilitator.

8) **Leverage work performed in fulfillment of the coordinated effort:**
The participating state(s) should leverage work performed in fulfillment of the coordinated effort, even when completed by other states within the group. Participating state(s) should avoid creating duplicative documentation and instead include a limited number of hyperlinks and/or key workpapers that are necessary to understand where coordinated work is located.

9) **Provide adequate oversight of its own staff, contract examiners, specialists and consultants:**
It is not the responsibility of the Exam Facilitator to supervise personnel from other states on a day-to-day basis. Each state must provide adequate oversight of its examiners, regardless of whether they are state employees or contract examiners, and should consider the allotted time that has been budgeted for the work of that state’s resources. Each state will be held accountable for the performance of personnel it has scheduled on any group examination.
10) Be engaged throughout the examination:
The participating state(s) should be informed and prepared to share information and perspectives pertinent to the
group examination and the respective domestic insurers. This includes actively participating in conference calls and
meetings arranged by the Exam Facilitator.

Participation at the conclusion of the exam

11) Participate in the exit conference:
Demonstrate participation in the exit conference hosted by the Exam Facilitator by providing any relevant
information, input and conclusions on the group exam, as well as input on exam deliverables; i.e., exam report,
management letter. As discussed in the “Responsibilities of Exam Facilitator” section above, when preparing
examination deliverables, guidance at Section 2-7 should be considered.

12) Close individual examination(s) in FEETS:
Upon the completion of the individual examination(s), the participating state should ensure that the individual
examination(s) for its domestic(s) being examined as part of the group examination are linked to the group exam
call in FEETS (if not already done). The participating state must distribute the report(s) of its domestic(s) to the
states in which the insurer(s) are licensed and/or transacting business by uploading the exam report(s) to FEETS
and closing the exam. This shall occur no more than 30 days beyond the adoption date of the exam report(s). When
closing the examination(s) in FEETS, include the next planned “as-of” date for each domestic, consistent with what
was discussed during the exit conference.

Special Considerations Related to Coordinating Group Exams

Differing exam cycles:
The Lead State should take state statutes into consideration because they may differ regarding how often a financial
examination is required (e.g., three to five years). Several insurers within a holding company system with different states of
domicile may be on varying cycles when their exams are performed. If it is deemed beneficial for states to participate on a
group exam even though their legal entities are not yet due for an examination, those states, after discussions with the Lead
State, may consider accelerating their next exam “as-of” date in order to match the “as-of” date of the group examination.

Use of subgroups:
It is important to note that complete coordination may not improve the examination efficiencies for some groups. In some
circumstances, the Lead State may separate the companies within a group on different examination schedules. Regulators
will be able to utilize the NAIC Group Exam Report in FEETS to assist with determining how companies within the group
may have been separated into subgroups based on previous group exams performed. The use of subgroups should also be
described in the coordination plan for the group.

Responding to a specific issue/concern not relevant to the entire group:
A situation may arise where a domestic regulator has concerns about a particular insurer within a group that is not determined
to be significant to the group overall. In these situations, in order to attempt to keep domestic insurers coordinated as part
of a group examination, the domestic regulator should consider performing a limited-scope exam on that entity, if possible.
However, if a limited-scope exam is insufficient and a full-scope examination of the domestic entity is warranted outside
the normal group exam schedule, the Lead State should be notified and the examination should be performed by the domestic
regulator utilizing work previously completed by the group as appropriate. After the examination is performed, the domestic
regulator should attempt to coordinate future examinations with the group if at all possible.

Non-participating states utilizing group examination work:
Although a state may be unable to participate on a group examination at a certain point in time, that state may benefit from
receiving group exam workpapers completed at any time during the exam period for its individual domestic exam(s). In
these cases, the non-participating state should contact the Lead State and Exam Facilitator directly to obtain access to those
workpapers and they should be made available. The non-participating state should give adequate time for the request to be
fulfilled and for the requested workpapers to be adequately reviewed before the work is provided to the non-participating
state. This does not require a review of all the exam work, but only the specific work requested so the work can be received timely.

Similar to utilizing the work from external/internal auditors, if an examiner plans to utilize documentation that was performed on a group exam from a year prior to the current examination “as-of” date, the examiner should obtain evidence that the item documented (e.g., internal controls) has not changed subsequent to the prior period testing. The more reliance that is placed on the prior period documentation received from the group exam, the more examination evidence should be obtained. Verification that the item documented has not changed should be obtained by a combination of inquiry, observation, reperformance and examination of documents, and should be clearly documented in the examination workpapers. If it has significantly changed since the prior period, the examiner should not utilize the prior period workpapers for that area as examination evidence.

Pooling arrangements and the use of group materiality:
When conducting an examination of a group that pools 100% of its business through the use of a pooling arrangement, it may be acceptable to calculate materiality at the group level. Group materiality may be beneficial for these situations because the risks are consistently shared throughout the group, and any detail testing that is based on materiality will take all the transactions of the group into consideration. With the Exam Facilitator leading the discussion, the regulators within the group should determine if this is appropriate for the group of insurers in a pooling arrangement and if exam evidence is being obtained for all insurers under examination.

E. Review and Reliance on Another State’s Workpapers

State insurance regulators have recognized that coordinating regulatory efforts helps ensure a more complete understanding of an individual company within the context of the insurance holding company group of which the individual company is a part. Insurers within an insurance holding company group may have common management and similar information systems and/or control processes. Therefore, if the insurer under examination is part of an insurance holding company group, the domestic state could benefit from the work of another state if that other state’s examination procedures address the domestic insurer’s financial statements or internal control procedures.

Depending on how the examination is coordinated, the extent of documentation required to explain the reliance of a domestic state on the work of another state varies. There are three general scenarios that may affect the extent of documentation.

1) **Lead State/Exam Facilitator:**
   When a coordinated group examination is conducted, the Lead State/Exam Facilitator is responsible for the overall quality of the work performed in support of the coordinated exam conclusions. Any work performed that is solely related to an individual domestic is excluded from the Lead State/Exam Facilitator’s responsibility. For a discussion of specific responsibilities of the Lead State/Exam Facilitator, refer to the “Responsibilities of the Lead State” and the “Responsibilities of the Exam Facilitator” sections above. Additionally, Exhibit Z, Part Two – Section A and/or Exhibit Z, Part Two – Section B should be completed in this scenario.

2) **Participating State in a coordinated group examination:**
   To demonstrate adequate participation, the participating state should complete Exhibit Z, Part Two – Section C to assist in documenting compliance with the responsibilities outlined in the “Responsibilities of States Participating in a Coordinated Exam” section above. Such documentation may be supplemented by a separate memo, if deemed necessary, to demonstrate compliance. In addition, the participating state assumes ownership of any state-specific procedures that are performed and is responsible for the quality of such work.

3) **States not participating in a coordinated group examination:**
   States in this category conducted a standalone examination separate from the coordinated group examination. States in this category are responsible for all work contained in the examination file. If a state is utilizing existing work but was not directly involved in the planning, oversight and review of the examination work, this state takes ownership of the project and is responsible for the overall quality of work performed in support of examination conclusions.
This state should perform a review of the testing state’s work program and conclusions to ensure the work being relied upon is sufficient to meet the needs of its examination. When determining the extent of review, the state utilizing the work of another state should consider its comfort and experience with the quality of work performed by that state. In addition, the accreditation status of other states may also be considered in determining the level of review to be performed by the relying state. Exhibit Z, Part Two – Section D should be completed in this scenario.

F. Coordinated Examinations of Internationally Active Insurance Groups

U.S. based insurance holding company systems that operate internationally are identified as Internationally Active Insurance Groups (IAIGs) if they meet the following criteria included in Model #440:

1. Premiums written in at least three countries;
2. The percentage of gross premiums written outside the United States is at least ten percent (10%) of the insurance holding company system’s total gross written premiums; and
3. Based on a three-year rolling average, the total assets of the insurance holding company system are at least fifty billion dollars ($50,000,000,000) or the total gross written premiums of the insurance holding company system are at least ten billion dollars ($10,000,000,000).

For coordinated examinations of IAIGs where a state insurance regulator is acting as the global group-wide supervisor (typically the lead state in the case of a U.S. based insurance group), appropriate procedures related to group-wide activities and risks should be conducted. Such areas are largely consistent with the International Association of Insurance Supervisors’ (IAIS) Common Framework for the Supervision of Internationally Active Insurance Groups (ComFrame) deemed applicable by state insurance regulators. While the financial analyst is typically responsible for many of the group-wide supervision activities, certain elements of ComFrame may be evaluated more effectively through onsite examination procedures. These procedures are incorporated throughout the Handbook (identified by †), as applicable, and are summarized in the chart below.

<table>
<thead>
<tr>
<th>ICP Ref</th>
<th>Topic</th>
<th>Exam Procedure/Exhibit Reference</th>
</tr>
</thead>
<tbody>
<tr>
<td>ICP 5</td>
<td>Corporate governance framework at the IAIG, including suitability of key individuals at the Head of the IAIG</td>
<td>Section 2, Part I&lt;br&gt;Exhibit E – Audit Review Procedures&lt;br&gt;Exhibit M – Corporate Governance Assessment&lt;br&gt;Exhibit Y – Examination Interviews</td>
</tr>
<tr>
<td>ICP 7</td>
<td>Risk management framework at the IAIG, including groupwide considerations for internal control systems; internal audit, compliance, and actuarial functions; and outsourcing activities/functions.</td>
<td>Section 1, Part III&lt;br&gt;Section 1, Part XI ORSA&lt;br&gt;Exhibit M – Corporate Governance Assessment&lt;br&gt;Respective Key Activity Examination Repositories</td>
</tr>
<tr>
<td>ICP 8</td>
<td>Considerations of policies and practices for relevant key activities:</td>
<td>Section 1, Part I&lt;br&gt;Exhibit AA – Summary Review Memorandum</td>
</tr>
<tr>
<td>ICP 15</td>
<td>• Investments&lt;br&gt;• Claims management&lt;br&gt;• Reinsurance&lt;br&gt;• Actuarial function</td>
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<tr>
<td>ICP 16</td>
<td>Group-wide risk assessment and inspections</td>
<td></td>
</tr>
<tr>
<td>ICP 23</td>
<td>Determination of an IAIG and the Head of the IAIG</td>
<td>Section 1, Part I&lt;br&gt;Exhibit AA – Summary Review Memorandum</td>
</tr>
</tbody>
</table>

While the considerations and procedures outlined in the chart above are applicable to insurance groups identified as IAIGs (see state adoption of Model #440 Section 7.1), similar procedures applicable under the state’s adoption of Model #440 Section 6 may also be appropriate for use in the supervision of other large insurance groups that do not meet the IAIG criteria. In assessing any such application, state insurance regulators must not exceed their legal authority and any supervisory measures should be risk-based and proportionate to the size and nature of the group.
ComFrame is to be applied flexibly and proportionately and therefore not every additional area of IAIG supervision will apply to each IAIG or will apply in the same way or to the same extent. Group-wide supervisors have the flexibility to tailor implementation of supervisory requirements and application of insurance supervision. ComFrame is not a one-size-fits-all approach to IAIG supervision as the goal is to achieve the outcomes set forth in ComFrame. IAIGs have different models of governance (e.g., more centralized or more decentralized). ComFrame does not favor any particular governance model and is intended to apply to all models. The organization of an IAIG can be structured in various ways as long as the intended outcomes are achieved. Proportionate application, which is called for in IAIS guidance, involves using a variety of supervisory techniques and practices tailored to the insurer. The techniques and practices applied should not go beyond what is necessary in order to achieve the intended outcomes of the IAIS’ Insurance Core Principles and ComFrame.

Additional guidance and discussion regarding the state insurance department’s supervision of IAIGs, including procedures for identifying IAIGs, identifying the scope and Head of the IAIG, determining the group-wide supervisor, the applicable roles and responsibilities, and authority related to the supervision review process can be found in the Financial Analysis Handbook.

**FG. Examinations of Underwriting Pools, Syndicates and Associations**

The examination of an underwriting pool, syndicate or association is the responsibility of the state in which the organization operates and, if it operates in more than one state, its examination should be coordinated by the Lead State, if possible.

The Lead State of an underwriting pool, syndicate or association is the one in which the organization’s principal office is located. The Lead State shall set the time and supervise the conduct of the examinations and shall have discretion in inviting other states to participate in the examination and in defining their participation. The Lead State shall input the report on examination into FEETS and ensure each interested insurance department, each company that is a subscriber or member of the examined organization and the chair of the Financial Condition (E) Committee has access to a copy of the report. Each state in which an organization operates, however, shall have the right to examine the report, and any such state may commence its own examination, if it deems necessary to do so, upon notice to the Lead State.

Each state is encouraged to recognize such reports on examination as official state documents, obviating the need for duplicative examinations, to establish procedures for reviewing these reports and to investigate and act upon any violations of law that they may disclose.

Where explicit regulatory authority does not exist over an underwriting pool, syndicate or association, each state in which it operates should negotiate with the organization itself, or with its subscribing members, to obtain an agreement that the organization will submit to the insurance department’s examination and will pay examination fees and charges assessed against it.

**GH. Special E Committee Examinations**

1. A special E Committee examination may be called by the NAIC Financial Condition (E) Committee if:
   a. Written reports from the non-domestic participating examiners indicate the examination conducted by the company’s state of domicile is inadequate.
   b. The home state is reluctant to schedule an examination when IRIS results or other information indicate the need.
   c. A state in which a company is licensed requests a special E Committee examination.
   d. A report of examination has not been filed within 22 months of the “as-of” date for an exam on a multi-state insurer and a special E Committee examination is requested by the Examination Oversight (E) Task Force.

2. Special E Committee examinations are staffed with personnel selected from state insurance departments by the Financial Condition (E) Committee.
3. Special E Committee examination reports should be addressed directly to the Financial Condition (E) Committee.
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

A. General Information Technology Review

The examination of information technology (IT) utilized by an insurer has become an increasingly important part of the examination process as companies have placed a greater reliance on IT systems to run their business. IT general controls (ITGCs) are policies and procedures that help ensure proper operation of computer systems, including controls over network operations, software acquisition and maintenance, and access security. ITGCs provide a foundation necessary to ensure the completeness, integrity and availability of IT systems and data and comprise the environment from which application controls are designed, implemented and operated. An effective IT general control environment can, therefore, provide examiners with greater assurance regarding the overall reliability of a company’s IT systems and the reports generated from those systems. In addition, this allows the opportunity to test and rely on automated application controls during Phase 3 of the exam. As such, a formalized process to complete a general IT review has been developed to assist the IT examiner in completing this important section of the financial condition examination. In a risk-focused examination, steps 1–5 of the general IT review process should be performed prior to the completion of planning the overall financial condition examination. Step 6 of the IT review process should be performed in conjunction with the remaining portion of the overall examination. The following steps document the process to be followed in completing the general IT review:

1. Gather Necessary IT Planning Information

The first step in performing a general IT review is to gather the information necessary to plan the IT review of the insurer. At this time, the examiner-in-charge (EIC) and the IT examiner should work together to request that the insurer complete the Information Technology Planning Questionnaire (ITPQ), included in Exhibit C – Part One, to assist in the planning process. In addition, other relevant information to obtain in planning the IT review might include prior examination workpapers, work on IT systems performed by internal/external auditors or consultants, and information maintained by the insurance department’s financial analysts. The reports and results from third-party cyber self-assessment tools may also be utilized for an IT review. Note that if companies do not use these tools, the examiner can continue with the normal IT review process. There are a variety of cyber self-assessment tools that companies may opt to use depending on their business type. Examples of cyber assessment tools that have been developed include, but are not limited to, tools developed by, or to facilitate compliance with the following: the Financial Services Sector Coordinating Council (FSSCC), the Health Information Technology for Economic and Clinical Health Act (HITECH), and the Health Insurance Portability and Accountability Act of 1996 (HIPAA). Based on a consideration of the assessment tool’s scope, date of preparation, and quality of information presented (including whether or not the information has been validated by an independent third party), the state insurance regulator may determine the information contained within the assessment that can be extensively leveraged during the IT review. Depending on the assessment of the IT examiner, the results of the cyber self-assessment tool may be used to:

• Populate Exhibit C with risk statements and controls to be tested.
2. Review Information Gathered

After the information for planning the IT review has been gathered, including the ITPQ, the IT examiner should review the information obtained to assist in planning and determining the scope of the general IT risks to be reviewed. Some factors to consider as part of this process include:

- The complexity of the insurer’s information systems and IT risk mitigation strategies;
- The extent to which reliance will be placed on those risk mitigation strategies in the financial examination;
- The length of time the existing system has been in place and any significant changes to the system;
- The types of subsystems being used and how data is shared among systems;
- The hardware and software being used and whether the software was internally or externally developed;
- The extent to which the insurer outsources its IT functions;
- Past issues the insurer may have had with its systems;
- Answers provided from the insurer via the ITPQ;
- Documentation available from other sources, including external and internal auditors;
- The insurer’s participation in electronic business and electronic data interchange;
- The amount of reliance placed on the work of third parties;
- The type, volume, and external availability of sensitive information that is processed and/or stored by the company and;
- Changes to the company’s controls and/or processes to ensure compliance with the General Data Protection Regulation (GDPR), if applicable, or other relevant data protection requirements.

The IT examiner should consider which risks included on the Evaluation of Controls in Information Technology (IT) Work Program (Exhibit C – Part Two) are applicable to the insurer under examination and determine if there are additional general IT risks that should be reviewed for this insurer. Additionally, based on the review of internal and external audit work, the IT examiner may determine that sufficient testing has been performed to fully address specific risks or areas of concern. In this case, the IT examiner may document in the IT planning memo their comfort with, and planned reliance on, the specific internal and/or external audit work included in the file. Additionally, the IT examiner need not include these specific risks or areas of concern in the IT work program.

3. Request Insurer Control Information and Complete IT Review Planning

After the initial planning information has been gathered and reviewed, the Evaluation of Controls in Information Technology (IT) Work Program (Exhibit C – Part Two) to be utilized in the review should be created. As part of this process, the IT examiner should customize the standard work program to include only the general IT risks that are of concern for the insurer under examination. In addition to providing a list of risks in the work program, the IT examiner may wish to provide a list of common controls that indicate how a typical insurer may mitigate these risks to assist the insurer in developing its response. Finally, the IT examiner may consider prompting the insurer to include information supporting the IT controls in place to mitigate risks by including an information request in the work program distributed to the insurer. The IT review team should coordinate with the appropriate staff at the insurer to request a response. The insurer’s response should indicate their controls in place to mitigate the risks identified in the work program. The IT examiner should review the company responses, considering the adequacy of the controls identified, and request evidence to test the effectiveness of the insurer’s mitigating controls. The IT examiner may consider some of the examination procedures listed in the Evaluation of Controls in Information Technology (IT) Work Program (Exhibit C – Part Two), and complete the planning of the IT review.

After the work program has been finalized, the IT examiner should document the plan to complete the IT review. The plan should document the staffing to be used to complete the review, the scope of work to be performed and a proposed budget to complete the review. The plan should be subject to the review and approval of the EIC and
additional examination supervisors, as considered appropriate by the state. This plan may be documented through the use of an IT review planning memo, or other workpaper that documents the approval of the EIC.

4. Conduct IT Review Fieldwork

The IT examiner should schedule examination fieldwork, with the initial fieldwork to include conducting interviews of key IT staff. These interviews should serve as an opportunity to substantiate and clarify some of the information provided by the insurer in Exhibit C – Part Two. The IT examiner may also gain additional information relating to key activities, risks, and risk mitigation strategies for the financial examination. As such, the IT examiner may want to invite the examiner-in-charge and/or other financial examination staff to participate in the interview process. Some of the potential candidates for interview include the Chief Information Officer, Chief Technology Officer, Chief Security Officer, System Architect, Chief System Engineer, and any other individuals responsible for maintaining, updating and testing the insurer’s business continuity and disaster recovery plans. Example agenda items for IT interviews, subject to the areas of expertise for the interviewee, include but are not limited to:

- IT Strategic Planning;
- IT Governance;
- Leadership development and succession planning;
- Organizational structure;
- Risk management;
- Development and maintenance of policies;
- Budgeting;
- Security;
- E-Business;
- Business continuity;
- Acquisitions and integration;
- Architecture, development and implementation of major programs;
- External environment, and
- Any other items necessary to evaluate the insurer’s general IT controls.

After the IT review team has completed the interviews, the team should begin to test the general controls identified by the insurer. This work should be completed with the assistance of the insurer’s IT staff and should utilize the existing work of others, if deemed appropriate. As noted in step 2 above, if the IT examiner has determined that reliance will be placed on all or some of the work performed by CPAs or the company’s internal audit function (if deemed independent) to fully address a specific risk or area of concern, the IT examiner would not be required to include those specific risks or areas of concern on the work program. However, if the IT examiner determines that the work performed by the third-party only partially addresses a risk, but additional work would be required to fully address that risk, the IT examiner should include the relevant third-party documentation in the file and map or link it to the respective risk in the work program.

While it is expected that audit work (external/internal) would be the most common type of work relied on by the exam team, work performed by other regulatory agencies and/or cybersecurity experts may also be leveraged to reduce the independent work performed during an exam. Regardless of the work being reviewed, state insurance regulators should specifically consider the scope of work, the independence and qualifications of the entity (or person) performing the work, the timing of the work performed, and the findings included in any report received. Qualifications should be evaluated based on the training, experience and education of personnel performing the work (see Section 1-2 Letter E for more information on the use of specialists). Based on the state insurance regulators’ review of the third-party work, state insurance regulators may be able to use the work to enhance the risk assessment, interview, and scoping process performed during the IT review. While the IT examiner is responsible for performing his/her own independent risk assessment, third-party work that directly addresses an identified risk may be relied upon in a similar manner to external/internal audit work. In this case, the IT examiner should briefly document his/her understanding of the third-party testing performed and any conclusions reached from the testing procedures. To the extent that findings are noted in the report obtained, state insurance regulators
may find it more useful to corroborate the remediation of the findings as opposed to performing an independent review of the company’s controls to confirm the findings’ existence.

After considering the utilization of existing work, testing of general IT controls and other procedures should be performed in order to gain an appropriate level of understanding of the insurer’s IT environment and the effectiveness of general IT controls in place. As noted above, the IT examiner may consider performing examination procedures listed in the Evaluation of Controls in Information Technology (IT) Work Program (Exhibit C – Part Two) or any other procedures necessary to conclude upon the effectiveness of the company’s general controls in mitigating the risks identified. All testing should be documented appropriately to ensure that the work may be referenced within the financial examination workpapers, as necessary.

5. Document Results of IT Review

At the conclusion of the IT review fieldwork (at or prior to the conclusion of planning of the financial examination process), the IT examiner should have a completed IT controls work program supported by documentation and testing as a deliverable. In addition, a summary of findings regarding the insurer’s IT environment and general IT controls should be prepared at this time. The findings may be considered prospective in nature (resulting in recommendations to the company) or current in nature (which may have an impact on the financial exam). These findings should be documented through the use of an IT summary report (or similar document), which should include a description of recommendations to the company and/or how the findings may impact the examiner’s reliance on general IT controls and approach to application control testing in Phase 3. The IT summary report may also include a summary of the insurer’s IT operations, and detail on the IT review work performed. Based on the impact of the findings, the IT examiner should determine whether the ITGC environment is generally effective. A generally effective environment would indicate that IT risks have been sufficiently mitigated and findings are not pervasive enough to limit the ability to allow for testing of application controls in Phase 3.

From the IT examiner’s perspective, controls over IT systems are considered generally effective when they maintain the integrity of information and the security of the data that such systems process and when they include effective general IT controls and application controls. Typically, at the end of the IT review, the ITGC environment would be considered generally effective, unless specific adverse findings summarized in the IT summary memorandum indicate otherwise. Professional judgement and skepticism should be exercised when making this determination. Often, even when issues are identified, the IT examiner may be able to determine that the finding is isolated to a specific system or point in time and, therefore, would not impact the overall reliability of the ITGC environment. In this case, the IT examiner should document in the IT summary memo which key activities or specific applications may be impacted by IT review findings and how.

In some instances, the overall ITGC environment may be deemed ineffective. In reaching this conclusion, the IT examiner should consider whether the findings outlined in the IT summary report:

- Are pervasive throughout the ITGC environment.
- Significantly impact the systems used in calculating and reporting financial results or the accuracy of information used in reaching major strategic decisions.
- Indicate deficiencies relating to management involvement and oversight of the IT strategy and direction.
- Are not alleviated by other mitigating factors.

If the ITGC environment is not deemed generally effective, the examiner may perform additional testing in later phases of the exam before relying on system generated reports or application controls in place of the insurer. The additional testing procedures should be designed to prove that the application control or system report is complete and correct despite the generally ineffective ITGC environment. Whether the ITGC environment is deemed generally effective ultimately depends on the IT examiner’s professional judgment. To determine the impact of the IT review findings on the remainder of the examination, the examiner should next consider if the nature of the findings affects the quality of information produced by the company’s applications and systems. For instance, a finding that the company has inadequate continuity management controls may be significant. However, such a finding would be unlikely to affect information produced by the company’s IT systems. The IT examiner should
SECTION 1 – GENERAL EXAMINATION GUIDANCE

General Considerations

assess ITGCs with regard to their effect on applications and data that become part of the financial statements or are used in making strategic business decisions.

The examiner may also consider performing additional procedures to determine the extent of the impact of specific findings. For instance, the company may have deficient user access controls. If the examiner is able to determine that in the period under examination, the key systems to the exam were not accessed inappropriately, the impact of the examination’s findings may not substantively affect the examination in later phases of the exam beyond the reporting of the finding. Given the complexity of evaluating the impact of individual findings and/or findings in the aggregate, communication of the results and mitigating factors in the IT Summary Conclusion Memorandum is important.

The IT examiner is cautioned against defaulting to the conclusion that the overall ITGC environment is ineffective, as such a conclusion could have a significant impact on the approach taken by the financial examiner on the remainder of the examination. For instance, in Phase 3, the examiner would be required to test manual or compensating controls for an identified risk if application controls cannot be relied upon and, therefore, may not be able to reach strong controls reliance. This may lead to additional detail testing in Phase 5 to fully address the identified risk. Additionally, the examiner would be required to test the accuracy and completeness of system generated reports, prior to those reports being utilized in addressing the identified risk in Phase 5.

The IT review process outlined up to this point, along with the corresponding documentation of results, may be performed on each examination, regardless of insurer size. These documents should also be appropriately presented and discussed with the examiner-in-charge to help facilitate a general understanding of the IT systems in place at the insurer and the impact that any findings may have on the ongoing exam.

6. Assist on Financial Examination

Following the completion of the IT review of the examination, the IT examiners involved in the IT review should remain available to assist in the completion of the financial portion of the examination. Such assistance could include data mapping, ACL testing, clarification of work performed during the IT review, assistance in completing the examination report and recommendation letter, and additional assistance in testing IT application controls to mitigate risks identified by the financial examination team.

Although the identification and assessment of risk mitigation strategies is the responsibility of the examination team as a whole, the IT review staff may have additional insight and experience that may be beneficial in identifying and testing IT controls associated with particular insurer applications. The involvement of IT review staff in this area of the examination may be especially beneficial when examining companies with well documented internal controls that may allow the examination team to reduce substantive testing.

Cybersecurity Considerations

As the examiner reviews an insurer’s operations, he or she may determine that the insurer has significant exposure to cybersecurity risks. The specific risk exposure for the insurer may vary based on volume, type of sensitive information (e.g. Social Security numbers, protected health information, personally identifiable health information, etc.) and the broad security environment in which the insurer is operating. The examiner should be mindful that the insurer is not required to use any particular IT security framework, nor are its IT security systems or controls required to include all of the components of any single or particular IT security framework or the examiner’s work program. The examiner should broadly consider not only the volume and type of sensitive information obtained, maintained or transmitted by the insurer, but also the laws and regulations to which the insurer is subject, as well as the size and complexity of the insurer’s operations and the nature and scope of its activities. All of these factors will influence the cybersecurity policies and systems and the IT security framework or frameworks that are appropriate for a particular insurer to effectively protect its sensitive information. As a result, responding to a particular insurer’s risk will require judgment by the examiner in tailoring the use of existing Handbook guidance. In these situations, examination teams should review the insurer’s risk mitigation strategies and/or controls that identify cybersecurity risks to protect against and detect cybersecurity incidents, and respond to and recover from cybersecurity incidents when they do occur.
When assessing the level of an insurer’s cybersecurity controls/processes, the examiner should take into account the distinction between the roles of the insurer’s board of directors and its senior management. The examiner should recognize that, while it is the role of the board to understand and oversee the insurer’s cybersecurity policies, systems and controls, it is the role of its senior management to implement the insurer’s cybersecurity policies and to ensure the performance and outcomes of the insurer’s risk mitigation strategies and controls are appropriate. Strategies and controls should identify, protect against, and detect cybersecurity incidents, as well as allow the insurer to respond/recover from such incidents. Each of the primary information security functions are described below:

- **Identify** - The identification of cybersecurity risks is important in helping the organization understand the best way to deploy its limited resources. Internal risk assessment is crucial for organizations to understand constantly evolving risks. Participation in information networks, though not required, is likely to enhance understanding of risks. In a robust control environment, insurers devote resources to a risk assessment process that includes some amount of management/board involvement, appropriate to the distinct roles of the board and senior management, as well as a sufficient level of technical expertise to ensure that issues are well understood and responded to appropriately.

- **Protect** - Protection is an important element in the overall strategy for any risk and cybersecurity is no exception. A robust risk mitigation strategy may include a combination of strong policies, system and network access controls, and data security protection (e.g. data-at-rest, in use, in transit, and in storage are protected, etc.), as appropriate to the broad security environment in which the insurer is operating, including the volume and type of sensitive information obtained, maintained, or transmitted by the insurer, the security laws and regulations to which it is subject, its size and complexity, and the nature and scope of its activities. When applicable, controls should directly address risks presented by third party access to the insurer’s network, systems and data (including access by vendors, agents, brokers, third-party administrators [TPAs] and managing general agents [MGAs]). Training is also an important part of the insurer’s response to cybersecurity risks as many incidents occur due to improper execution of controls rather than the lack of controls. Control effectiveness is limited if employees are not provided adequate training to understand the objectives and importance of their assigned responsibilities.

- **Detect** - Insurers should also have a strong set of detective controls that enable timely identification and mitigation of threats to the organization. These may include anti-virus and anti-malware software as well as network monitoring and intrusion detection related processes and controls. Organizations may perform vulnerability scans and penetration tests to ensure that weaknesses in the protective/detective controls are identified and addressed.

- **Respond and Recover** - A review of the insurer’s incident response plan is an important consideration in the overall assessment of cybersecurity at an insurer. The response to a cybersecurity incident may leverage concepts from the insurer’s broader disaster recovery plan, but may also require unique considerations since recovering from a cybersecurity incident requires a different response than recovering from an environmental incident (e.g. fire, earthquake, tornado, etc.). The examiner should note, however, that network threats and incidents are not rare events like environmental incidents. It is also important that people with assigned responsibilities within the disaster recovery plan have the necessary background/training to perform the assigned duties. Insurers should include in their plan who they are required to contact in the event of a security incident (regulators, affected parties, etc.) and how public relations will be managed to limit the impact of the incident on the organization’s reputation. Importantly, response plans should be tested to ensure that the organization is ready to deploy the plan in the event of an actual incident.

When significant incidents do occur, it is important that the insurer performs a thorough post-remediation analysis and restores services that were affected as a result of the incident in accordance with the response plan. Examination teams may consider reviewing incident reports to consider how the organization has learned and adapted when security protocols are breached.

Depending on the insurer’s operations, there may be unique risks that the examiner identifies for further review. For instance, some insurers may leverage controls at service providers to provide assurance over cybersecurity risks. While this may be appropriate, insurers should be able to confirm that the service provider has appropriate risk mitigations strategies
and controls in place and that appropriate protections are built into their service agreement (e.g. indemnification clauses, right to audit, technology errors and omissions insurance coverage, etc.) to address the risks presented to the insurer.

Although uncommon, if the examiner determines that the insurer has significant exposure to cybersecurity risk, the examiner may consider incorporating the use of a cybersecurity expert to assist in performing cybersecurity procedures. The specific risk exposure assessment for the insurer should be based on the IT examiner’s judgment and may consider the insurer’s line of business, the size and complexity of operations, known cybersecurity incidents; risks presented by third-party access to the insurer’s network systems and data, recent acquisitions, concerns about the controls in place to protect against, detect, respond and recover from cybersecurity incidents, or any other significant risk factors related to cybersecurity. Note that the decision to use additional expertise to address cybersecurity concerns should be based on the accumulation of circumstances and not necessarily due to any one situation discussed above.

The following insights may assist regulators and/or cybersecurity experts as they assess the strength of the insurer’s security program and therefore the risk that cybersecurity events present to the insurer. These insights are for informational purposes and are not intended to be requirements for insurers. Companies may be assessed by their individual risk profile and the organization’s risk strategy.

**Events, Incidents and Breaches**

As regulators engage insurers in discussion regarding past cybersecurity events, it may be useful to understand the difference between various types of events. A “cybersecurity event” can be defined as an event resulting in unauthorized access to, disruption or misuse of an information system or information stored on such an information system. Insurance companies may also use terms such as incidents and breaches or may distinguish between successful and unsuccessful events as they discuss their cybersecurity program. Regardless, regulators should gain an understanding of how the insurer defines its events and incidents. Insurers should consider both unsuccessful cybersecurity events and successful cybersecurity events (incidents), as appropriate. For instance, while an unsuccessful event may only access the company’s network without accessing sensitive information, it may still represent an event that the insurer should consider, correlate with other activity, and learn from to ensure security practices are enhanced, as appropriate. Timely, effective incident response is extremely critical in minimizing the impact of a cybersecurity incident.

**Integration of Cybersecurity Risk into Enterprise Risk Management**

As noted before, an insurer’s board and/or senior management often play a significant role overseeing a cybersecurity program. As an insurer’s cybersecurity risk increases, examination teams may want to scrutinize the integration of cybersecurity risk into the insurer’s Enterprise Risk Management. This may include consideration of the level of information provided to the board and/or senior management and the appropriateness of the insurer’s risk identification and assessment process. It may be appropriate for board and/or senior management to receive summary level information, but there should be a designated person with cybersecurity expertise that is responsible for developing the insurer’s response to mitigate cybersecurity risks. This person should be deemed the insurer’s cybersecurity risk owner and should receive information that is tailored to the insurer’s specific cyber risk exposures. For instance, use of third-party service providers, integration of acquired companies, legacy systems, etc. may all represent unique exposures that require specific consideration as mitigation strategies are developed.

**Information Security Program**

*Note: The guidance that follows should only be used in states that have enacted the NAIC Insurance Data Security Model Law (#668). Moreover, in performing work during an exam in relation to the Model #668, it is important the examiners first obtain an understanding and leverage the work performed by other units in the department, including, but not limited to, market conduct-related work.*

Specific requirements related to an insurance company’s information security program are included in Model #668. States that have passed the law may have an enhanced ability to encourage remediation of control issues in relation to issues identified during the exam. To the extent a state has adopted Model #668 and it is in effect at the time of the examination, examiners may consider tailoring the IT review to include consideration of the items below. As evidenced below, implementation of each control identified for consideration shall be done based on the insurer’s individual risk assessment:
Section 4-C of Model #668 details the requirements for performing a risk assessment. As part of a risk assessment, the licensee shall perform the following:

1. Designate one or more employees, an affiliate or an outside vendor designated to act on behalf of the licensee who is responsible for the Information Security Program.

2. Identify reasonably foreseeable internal or external threats that could result in unauthorized access, transmission, disclosure, misuse, alteration or destruction of nonpublic information, including the security of information systems and nonpublic information that are accessible to, or held by, third-party service providers.

3. Assess the likelihood and potential damage of these threats, taking into consideration the sensitivity of the nonpublic information.

4. Assess the sufficiency of policies, procedures, information systems and other safeguards in place to manage these threats, including consideration of threats in each relevant area of the licensee’s operations, including:
   a. Employee training and management.
   b. Information systems, including network and software design, as well as information classification, governance, processing, storage, transmission and disposal.
   c. Detecting, preventing and responding to attacks, intrusions or other systems failures.

5. Implement information safeguards to manage the threats identified in its ongoing assessment, and no less than annually, assess the effectiveness of the safeguards’ key controls, systems and procedures.

Based on this risk assessment, Section 4-D requires the licensee to execute the following:

1. Design its Information Security Program to mitigate the identified risks, commensurate with the size and complexity of the licensee’s activities, including its use of third-party service providers, and the sensitivity of the nonpublic information used by the licensee or in the licensee’s possession, custody or control.

2. Determine which security measures listed below are appropriate, and implement such security measures.
   a. Place access controls on information systems, including controls to authenticate and permit access only to authorized individuals to protect against the unauthorized acquisition of nonpublic information.
   b. Identify and manage the data, personnel, devices, systems and facilities that enable the organization to achieve business purposes in accordance with their relative importance to business objectives and the organization’s risk strategy.
   c. Restrict access at physical locations containing nonpublic information only to authorized individuals.
   d. Protect by encryption or other appropriate means all nonpublic information while being transmitted over an external network and all nonpublic information stored on a laptop computer or other portable computing or storage device or media.
   e. Adopt secure development practices for in-house developed applications utilized by the licensee and procedures for evaluating, assessing or testing the security of externally developed applications utilized by the licensee.
   f. Modify the information system in accordance with the licensee’s Information Security Program.
g. Utilize effective controls, which may include multifactor authentication procedures for any individual accessing nonpublic information.

h. Regularly test and monitor systems and procedures to detect actual and attempted attacks on, or intrusions into, information systems.

i. Include audit trails within the Information Security Program designed to detect and respond to cybersecurity events and designed to reconstruct material financial transactions sufficient to support normal operations and obligations of the licensee.

j. Implement measures to protect against destruction, loss or damage of nonpublic information due to environmental hazards, such as fire and water damage or other catastrophes or technological failures.

k. Develop, implement and maintain procedures for the secure disposal of nonpublic information in any format.

3. Include cybersecurity risks in the licensee’s ERM process.

4. Stay informed regarding emerging threats or vulnerabilities, and utilize reasonable security measures when sharing information relative to the character of the sharing and the type of information shared.

5. Provide its personnel with cybersecurity awareness training that is updated as necessary to reflect risks identified by the licensee in the risk assessment.

Review section 3 of the Model #668 for legal definitions of relevant and commonly used terms. For purposes of the exam process, licensees include, but are not limited to, insurance companies. Model #668 also covers the topics of board of directors oversight, third-party service providers, program adjustments, incident response plan, and the annual certification to the commissioner of the domiciliary state. Review Model #668 language for further insights on the topics above.

Evaluating Employee Training / Security Awareness Programs

Employees often represent the front line of any strong security program. However, without proper training, employees may also represent vulnerability in the company’s defense program. Therefore, strong security awareness training can help in mitigating the risk presented by phishing e-mails and other social engineering attacks. Strong security awareness training may be characterized by:

- Use of real world examples to help users be able to identify phishing e-mails;
- Use of phishing emails sent to the user community by the insurers internal security specialists or security vendor to measure effectiveness of user training;
- A clear protocol that provides employees help in identifying and reporting phishing e-mails; and
- Elements of a training that are tailored to the employee’s specific roles, responsibilities, and access rights.

Since cybersecurity threats are constantly evolving, it is important to have a strong and up-to-date training regimen. Additionally, in a strong cybersecurity program trainings should be performed on a consistent and periodic (e.g. annually) basis to ensure the information reaching the employees is commensurate with the modern-day threats facing the company. As regulators evaluate the appropriateness of the program, they should consider whether the training is mandatory for all employees and whether it includes procedures and instructions for employees to follow in the event that the employee has a good faith, fact-based belief that a breach or cybersecurity event may have occurred.
Vulnerability Management

In the most robust information security programs, companies understand that not all vulnerabilities can be eliminated, typically due to business needs or time and resources. However, companies should have an understanding and should inventory their identified vulnerabilities as well as have a plan to ensure vulnerabilities that can’t be eliminated are mitigated as much as possible. For instance, if the insurer is unable to confirm that a third-party service provider is able to secure their own access to the company’s information system, the company should ensure they monitor the service provider’s access to determine if improper activity occurs on the company’s network. As many vulnerabilities originate with a company’s patching practice, it is important that regulators obtain an understanding of the company’s patch management. Research suggests that in any given year, the majority of breaches have a root in a Common Vulnerability and Exposure (CVE) that often has been known and identified for several years. An insurer should maintain a strong practice of patch management, or at least a practice of understanding and mitigating existing vulnerabilities as an important part of a robust security program. For vulnerabilities discovered between exam periods, the NAIC maintains a “Cybersecurity Vulnerability Response Plan” document on the Information Technology (IT) Examination (E) Working Group web page with company questions and follow-up procedures to learn more about the extent of the vulnerability, how that information can be used going forward, and possible actions to be taken, if warranted (e.g., targeted exam procedures, additional interim procedures, etc.).

Ransomware

Ransomware is one of the more common manifestations of a cybersecurity risk. Ransomware attacks pose a significant risk to confidentiality and availability of company data. It is difficult to predict when and where a ransomware attack will strike, so it is important for a company to maintain strong cyber hygiene habits to stay ready for ransomware attacks. At a minimum, insurers with good cyber hygiene do the following:

- Patch their systems/networks regularly, in a timely manner, and in accordance with application updates.
- Require strong passwords, and, where appropriate, multi-factor authentication.
- Have information security awareness training, including email filtering and anti-phishing training for employees, with periodic phishing test campaigns.
- Monitor and react to suspicious activity on their network.
- Have system backups that are stored in an air gapped, immutable environment that is inaccessible from the internet; this backup can be quickly deployed in the event the production environment is infected. Companies should test backup deployment regularly.
- Have firewalls, or other mechanisms within the network, so someone with unauthorized access cannot move laterally.
- Limit user access rights to the minimum necessary to perform their job.
- Have and test a robust incident response plan.

Company Acquisitions

Finally, in situations where a company has recently acquired/integrated another company, the IT examiner should also pay special attention to the procedures performed in integrating company systems. This is often when companies are most vulnerable to cybersecurity threats as controls are often in flux and mistakes in integration may create vulnerabilities that are not easily identified or remedied.

Exhibit C, Part Two (Instruction Note 3) includes specific mention of risk statements and sections of the exhibit that can be applied to ensure the examination has an appropriate response to identified cybersecurity risks.

Note that the findings identified through the review of the company’s cybersecurity control environment should be communicated to the financial examiner via the IT Summary Memo.

Uniformity of Data for Timely and Efficient Transfer

Legacy systems with uncommon and difficult-to-access data structures should be flagged for further investigation as part of the IT review. Companies with multiple IT platforms, multiple cloud storage providers, or that rely on managing
general agents (MGAs) or third-party administrators (TPAs) may be at a higher risk, especially if their data is stored in a commingled environment. The ability to migrate and transfer data may be relevant in a number of scenarios, including switching service providers, merging with or acquiring another company, company insolvency necessitating the transfer of policyholder data to the guaranty fund, etc. If the data is found to be in a format that is not conducive with timely and efficient data transfer, the IT examination team is encouraged to notify the insurer to discuss data migration and the possible need for a more uniform data standard (e.g., NAIC Uniform Data Standards [UDS] for property/casualty (P/C) companies). The IT examination team may also review contracts with third-party data storage providers for clauses on data transfer rights. The solvency outlook of the company may be considered when discussing if data migration to a more uniform format is necessary. See DSS 01.01 in Exhibit C for common controls; information requests; and possible procedures regarding the quality, timeliness, and availability of data. In summary, the data should be stored in a format that allows it to be accessed, utilized, and efficiently transferred, if necessary.

Note: While NAIC UDS apply specifically to P/C companies, all companies should have the ability to export claims data through a defined format that would allow the data to be received and utilized by a third-party guaranty fund, if necessary. See the NAIC Uniform Data Standard Operations Manual for more information. This manual is maintained by the National Conference of Insurance Guaranty Funds (NCIGF). The following sections would be most applicable to examiners:

- A Record Extended Table Appendix: IX
- B Record Extended Table Appendix: XIX
- G Record Extended Table Appendix: LVIII
- F Record Extended Table Appendix: LIV
- I Record Extended Table Appendix: LXV
- Coverage Codes: 15-1
- Transaction Codes: 14-1
- Other Code Tables: 16-1

**Customization for Small Companies**

When conducting an IT review of a small company or a company with a non-complex IT environment, it is acceptable to limit the extent of test procedures performed. However, the examination must adhere to the six-step process outlined above. This includes obtaining the ITPQ responses from the insurer, completing a basic work program, and preparing a summary memo concluding on the results of the IT review and its impact on the rest of the examination.

The most significant area to be customized for small insurers is the IT work program. Regardless of size or complexity, some level of testing is required to be performed to verify the design and operating effectiveness of the insurer’s IT environment; however, the presentation of such work may vary. It is recommended that IT examiners perform some level of review for IT general controls in place within each domain of the COBiT Framework. This may be shown using a customized version of Exhibit C – Part Two, where a limited number of controls applicable to the insurer are populated and reviewed. In limited circumstances, as described below, IT examiners may bypass the utilization of Exhibit C – Part Two:

1. If the CPAs or the company’s internal audit function (if deemed independent) have performed a review of ITGCs that sufficiently cover risks within each of the COBiT domains, the IT examiner may rely on such work without mapping or linking the work to a separate work program. However, the IT examiner must document their comfort with and planned reliance on the work performed.

2. When the IT environment is simplistic and the insurer utilizes purchased software programs from well-known vendors, IT examiners may choose to summarize, in memo format, the procedures performed for each domain of the COBiT Framework. However, before determining that it is appropriate to bypass the utilization of Exhibit C, IT examiners should consider whether the company has made significant modifications to the software being used, as modifications may impact the software’s reliability. In situations where significant modifications have been made and continue to be made, IT examiners should utilize Exhibit C – Part Two to document a consideration of risks relating to change management.
**B. Materiality**

The examiners should consider materiality before planning and conducting examination procedures and when evaluating the results of those procedures. Materiality is defined as the dollar amount above which the examiner’s perspective of the company’s financial position will be influenced. It is determined at two levels during the initial planning stage: (1) an overall level as it relates to the annual statement taken as a whole; and (2) an individual balance (annual statement line item) level.

**Considering Planning Materiality**

Planning Materiality (PM) is the examiner’s preliminary judgment of materiality made during initial planning. It is used in developing the overall scope of the examination procedures.

At the conclusion of the examination, the examiner evaluates whether the total effect of misstatements identified is material to the annual statement. Thus, it is necessary for the examiner to develop the scope of the procedures with a materiality consideration in mind. PM is used for that purpose. The amount considered material at the end of the examination may differ from PM since it is not ordinarily feasible to anticipate all the circumstances that may ultimately influence the examiner’s judgment about materiality used in evaluating the overall effect of misstatements on the annual statement. If the examiner determines that a significantly lower level of materiality is appropriate in evaluating the overall effect of examination differences, the examiner should reconsider the sufficiency of examination procedures.

The estimate of PM requires professional judgment, based on the examiner’s understanding of the company’s operations. The examiner needs to consider the (1) nature of the business, (2) operating results (e.g., stable earnings, consistently near break-even, volatile results), and (3) financial position. Consideration should also be given to how close the company’s surplus is to levels that would trigger regulatory action.

**Setting Materiality Levels**

Some of the factors that should be considered in determining PM are discussed below, along with examples of some measures that might be used. These are not the only measures or percentages that may be used – others may be appropriate based on professional judgment in particular circumstances. If a combination of measures is considered appropriate, the examiner should identify a range from which PM can be derived.

a. **PM Based on Capital and Surplus Levels** – Typically, fair presentation of capital and surplus levels is of primary importance in an examination. Generally, an appropriate starting point in computing PM is 1 percent to 5 percent of capital & surplus. What percentage of surplus to use depends on the circumstances of the examination. For example, as a company’s capital and surplus declines toward minimum levels, the percentage used probably would be at the lower end of the range. Alternatively, for a strong, well-capitalized insurer with no apparent concerns, the percentage likely would be at the high end.

b. **PM Based on Operating Results** – Another important financial measure is operating results, often the gain from operations. An appropriate starting point in computing PM is 5 percent of the pretax gain from operations. Whether to use current year income or an average of previous years’ income is a judgmental decision based on current economic conditions and earnings trends. In many situations, it will be appropriate to challenge the reasonableness of the different methods by computing income several ways.

The examiner should also consider the effective tax rate in setting PM. In some situations, the effective tax rate differs from the statutory rate due to a large capital gain, high level of tax credits, or nontaxable income. The starting point for PM assumes that a 5 percent change in pretax income will cause a 5 percent change in taxes and result in a 5 percent change in net income. Accordingly, PM may be a different amount in situations where the effective tax rate is significantly different from the statutory tax rate.

If the company operates at or near break-even or fluctuates between gain and loss from operations from year to year, pretax income may not be the most appropriate basis for computing PM. Also, because statutory accounting requires certain items to be reflected directly in surplus, statutory operating results may not be a good indicator of
materiality. Premium volume or total revenue measures may be more appropriate. Again, it may be preferable to use more than one measure to identify a range from which PM can be derived.

c. **PM Based on Financial Position** – Another measure to consider in determining PM may be one-half of 1 percent of total assets. As gains from operations diminish and become minimal, their usefulness as a point of reference for computing PM also diminishes. In those situations, a smaller percentage of total assets (e.g., one-fourth of 1 percent) may be the most appropriate base.

d. **Other Considerations** – The general guidelines discussed above should apply to most examinations. However, in special situations the examiner may need to consider additional factors. In all cases, the estimate of PM requires professional judgment and consideration of a variety of factors – as no set of general guidelines can be all encompassing.

**Documenting PM**

The examiner should document in the Examination Planning Memorandum the reasons underlying the determination of PM and the amount established as PM.

**Tolerable Error**

Tolerable Error (TE) is the materiality for a particular account balance (annual statement line item) affected by a specific examination objective. It is the amount of monetary error that can exist in a specific account balance without causing the financial statements as a whole to be materially misstated when added to errors in other account balances.

**Setting TE** – When examining an account balance based on a specified level of materiality, it is possible that some amount of error below that level is present, even if no errors are observed. As a result, if PM is used as the materiality level for specific examination tests, no margin is left for the aggregate effect of undetected errors. Thus, it is logical that the amount of TE set for each annual statement line item should be less than PM.

a. TE is a planning concept used to determine the amount of error that the examiner’s testing is designed to detect. When the results of such tests detect an amount of error approaching or exceeding TE in that account, the examiner should evaluate the cause of the error and consider performing additional procedures to refine the estimate of acceptable error.

TE is related to the preliminary estimate of materiality in such a way that, when combined for the entire examination plan, it does not exceed PM. In other words, TE should be set for each account so the probability is remote that the total of undetected errors, detected errors, and judgmental differences from all accounts will exceed PM.

There are various statistical approaches to setting TE. These approaches result in TEs for various accounts that when simply added together exceed PM. However, when aggregated according to statistical formulas, those individual TEs result in an overall level of materiality that approximates PM. In other words, not all errors will move in the same direction. Therefore, the TE assigned to all accounts need not be so low that the sum of all TEs is less than PM. The appropriate level for setting TE will vary by examination. However, as a general guideline, TE can be set at fifty percent (50%) of PM for each particular annual statement line item.

b. Considerations in Changing TE from 50% – There are some typical situations where it is appropriate to set TE at other than 50% of PM. In considering these situations, the examiner should be aware of the implicit judgment made when adjusting TE. As TE is increased, the examiner is implying that more risk can be accepted in the related account. This implication follows from the inverse relationship between TE and the extent of the examination procedures (the higher the TE, the smaller the sample size or, conversely, the lower the TE, the larger the sample size).

A higher TE also may be appropriate to use when the test’s purpose is to detect errors that would result in balance sheet reclassifications (e.g., misclassification of investments or policyholder deposits).
The examiner may wish to increase the nature or extent of the examination procedures in initial examinations or in examining the recently acquired operations of a company. Reducing TE in these situations is appropriate because the examiner would not have any experience on which to base expectation of errors.

**Passed Adjusting Journal Entry (PAJE) Scope**

During the course of the examination, the examiner may encounter errors that do not require adjustment in the report of examination. These errors must be accumulated using Exhibit BB – Summary of Unadjusted Errors in order to determine whether the errors are material in aggregate and an adjustment should be made. Some errors which are clearly immaterial should not be included within this summary. In order to determine a minimum dollar amount under which errors should be excluded, the examiner should calculate the passed adjusting journal entry (PAJE) scope.

**Setting PAJE Scope**

As a general guideline, the PAJE scope can be set at 20% of TE. When the examiner encounters errors that are below this amount, they should be excluded from the Summary of Unadjusted Errors. For example, if the PAJE scope is set at $50,000 and the examiner notes a $75,000 error and a $30,000 error, the $75,000 error should be included on the Summary of Unadjusted Errors, and the $30,000 error, which is below the PAJE scope, does not need to be included.

**C. Examination Sampling**

Exam sampling is defined as the application of examination procedures to less than 100% of the items comprising an account balance or class of transactions for the purpose of evaluating some characteristic of the balance or class. In Phases 3 and 5 of the risk-focused examination process, sampling is frequently used to obtain examination evidence by testing controls, attributes, and account balances. Applying proper examination sampling procedures will allow the examiner to improve efficiency and effectiveness in his or her examination.

Examiners take a risk-focused approach to evaluate the overall solvency of a company but are not required to opine on the financial statement dollar balances. Therefore, this guidance focuses on both the testing of controls in Phase 3 and the testing of details, primarily attributes, in Phase 5. The sampling approach outlined herein allows an examiner to gain comfort in key activity areas but may not always produce a statistically valid sample for purposes of projecting errors across a population or proposing exam adjustments. In instances where more precision in sample selection is necessary or this guidance is deemed too general, examiners should exercise professional judgment in utilizing other resources to direct the use of sampling techniques such as AICPA sampling guidance or electronic sampling tools (e.g. ACL, IDEA, TeamMate Analytics, etc.). However, in these instances, examiners are expected to provide a description of the tool or guidance and the examiner’s rationale for why using the tool or guidance is appropriate. The rationale should include a brief explanation of how the sample size was generated and justifications for any instances where the tool or guidance used contradicts concepts set forth by this Handbook.

Sampling worksheets have been developed to assist the examiner in determining, documenting, and concluding on sample selections. These worksheets can be found in *Exhibit O – Examination Sampling Worksheets* in Section 4 of this Handbook.

The remainder of this section is divided as follows:

a. Determining Reliance on Audit Procedures  
b. Selection of Testing Methodology  
c. Sampling for Testing of Controls  
d. Non-Statistical Sampling  
e. Attribute Sampling

**a. Determining Reliance on Audit Procedures**

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

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

b. Selection of Testing Methodology

The following graphic may be used to assist examiners in determining which sampling methodology to follow based on the objective of their testing.

<table>
<thead>
<tr>
<th>Testing Objectives</th>
<th>Sampling for Testing of Controls guidance</th>
<th>Non-statistical Sampling guidance</th>
<th>Attribute Sampling guidance</th>
</tr>
</thead>
<tbody>
<tr>
<td>Testing the operating effectiveness of a control?</td>
<td>Sampling for Testing of Controls guidance</td>
<td>Non-statistical Sampling guidance</td>
<td>Attribute Sampling guidance</td>
</tr>
<tr>
<td>Testing the accuracy of a dollar balance?</td>
<td>Sampling for Testing of Controls guidance</td>
<td>Non-statistical Sampling guidance</td>
<td>Attribute Sampling guidance</td>
</tr>
<tr>
<td>Testing the accuracy of a characteristic or attribute?</td>
<td>Sampling for Testing of Controls guidance</td>
<td>Non-statistical Sampling guidance</td>
<td>Attribute Sampling guidance</td>
</tr>
</tbody>
</table>

In some instances, it may be appropriate or more efficient for an examiner to perform dual-purpose testing. Dual-purpose testing occurs when an examiner chooses to use the same sampling selections for both a Phase 3 control test and a related Phase 5 test. When dual-purpose tests are performed, the examiner should clearly distinguish which elements of the test relate to Phase 3 and which procedures relate to Phase 5 within the exam workpaper documentation. Although the selections are the same, the results of the Phase 3 control testing still must be incorporated into the Phase 5 testing. For example, if an examiner determines that 40 selections is an appropriate Phase 3 sample size and the appropriate sample size for the related detail test is 55 selections (assuming related controls will be strong), the examiner should select a sample of 55 items and perform Phase 3 control testing on 40 of the 55 items. If there were no issues identified in the Phase 3 control test, the examiner should then perform their detail test as planned on all 55 selections. If issues were noted during the Phase 3 control test, the examiner should consider increasing the Phase 5 sample size and/or alternative procedures.

c. Sampling for Testing of Controls

In Phase 3, when sampling is considered appropriate for control testing, the examiner must determine the most efficient and effective way to perform tests of controls. The examiner should first identify the control being tested and the objective of the test. The most common control testing objective is to determine if the control is functioning properly and as designed throughout the testing period.

Automated controls consist of control processes performed by IT systems, and these differ from manual controls by generally eliminating the potential for human error (beyond overriding). If the examiner has determined that an automated control will consistently function in the exact same manner and IT general controls were deemed to be
effective (as documented in the IT Summary Memo), the examiner may be able to perform testing by observing one instance of the control. Controls can vary by computer system or line of business so examiners should test at least one occurrence of a control for each unique distinction. Common examples of where this treatment is appropriate are application controls that display an error message if duplicate information is entered or application controls that require an authorized person to approve a transaction before the transaction is processed.

The examiner should be cognizant of variables that may affect the examiner’s testing approach and control reliance, including whether the system is subject to changes or revisions and whether management has the ability to override the system. Inappropriate management override or system changes made on more than an occasional or inconsistent basis may result in the automated control not performing as designed; therefore, it would be inappropriate for the examiner to decrease the sample size to less than the calculated number of items. When reduced sample sizes are not appropriate, the following guidance should be utilized:

1) **Determine the control being tested.** The examiner should gain an understanding and document the design of the internal control the company has in place. This information is typically obtained through company control documentation, auditor control documentation, interviews, and/or walkthroughs with company personnel.

2) **Describe the objective of the test.** The objective of a test of controls is to provide the examiner with evidence about whether controls are designed properly and operating effectively. For example, to determine whether investment purchases have been authorized, the examiner could examine investment committee minutes or payment vouchers to determine if the authorized company personnel signed the payment voucher before processing.

3) **Define the population and an individual sampling unit.** The definition of the population should describe all possible items that will be included in the selection process. The examiner should also identify and document the source that the sample will be selected from, including the report name. A sampling unit should describe the type of item that is available for selection and will be subjected to testing.

4) **Define the period covered by the test.**

5) **Describe how completeness of the population was considered.** The examiner should determine that the population contains all appropriate items available to select in the sample.

Scheduled or cyclical controls are executed by the company on a routine basis. For example, bank reconciliations are generally completed by the company on a monthly basis and therefore performed 12 times per year. It is important to note that controls performed on a cyclical basis do not automatically qualify as “automated controls”. For a control to be automated, it must be performed by a computer system identically each time. Other controls are performed as often as a transaction or event occurs. For example, controls over a company’s collections process may be triggered whenever cash or cash equivalents are received. In general, the examiner will perform the same testing process for both cyclical and transaction based controls, although the number of test selections will vary based upon the number of control occurrences. The examiner should determine the number of occurrences that took place during the defined testing period and use this number to proceed with sample selection and testing.

6) **Define a deviation (error).** A deviation or error in a test of controls is a departure from the sufficient performance of a control. A deviation could also be defined as a selection for which the company is unable to provide sufficient evidence of proper control performance. If a deviation or error is discovered, the examiner should ask the company to provide an explanation and evaluate its appropriateness. A deviation or error that cannot be appropriately explained by the company is considered an exception.

7) **Determine the sample size.** The examiner may utilize the table provided below to determine an appropriate sample size. For example, controls that occur monthly (12 times per year) should have a sample size between three and five items. If any deviations are found that cannot be explained as isolated incidences, the final assessed level of risk management should be weak. To assist the examiner in documenting sampling for controls, the test of controls worksheet (Part One of Exhibit O) may be utilized. Examiners should follow the chart below to assist in
determining sample sizes and use professional judgment to choose the most appropriate sample size based on the number of occurrences during the sampling period.

<table>
<thead>
<tr>
<th>Control Frequency</th>
<th>Number of Control Occurrences in the Sampling Period</th>
<th>Sample Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>Annual</td>
<td>1</td>
<td>1</td>
</tr>
<tr>
<td>Quarterly</td>
<td>4</td>
<td>2</td>
</tr>
<tr>
<td>Monthly</td>
<td>12</td>
<td>3-5</td>
</tr>
<tr>
<td>Weekly</td>
<td>52</td>
<td>5-12</td>
</tr>
<tr>
<td>Daily or more</td>
<td>250+</td>
<td>25-40</td>
</tr>
</tbody>
</table>

8) **Select the sample.** Sample items should be selected in a manner that gives each item in the population an equal chance to be selected. Control procedures are expected to be applied to all transactions subject to that control. Examiners should use their professional judgment to determine a sample size from these ranges. As discussed above, examiners may select a sample that is below the given range if the control is automated and the company’s ITGCs were deemed effective.

9) **Document the deviations noted during the testing of controls.** A deviation exists when a control is not operating effectively, or as prescribed. The examiner should perform the testing of controls and document the number of deviations found as well as the reasons for those deviations. To aid the examiner’s understanding of a deviation, the examiner may ask the company to provide an explanation for the deviation. The examiner should document the nature and extent of the deviations, which should include the examiner’s opinion of the probability of similar deviations occurring. Deviations which do not have a plausible and verifiable explanation are considered exceptions.

10) **Conclude on the final assessed level of risk management.** If zero deviations are discovered during the testing of controls, the results of the test can be accepted and the examiner should use professional judgment to conclude on the final assessed level of risk management achieved from the test. For example, if the examiner tested a sample size of 40 and had no deviations, the examiner would generally conclude that the final assessed level of risk management is strong. If deviations are discovered during the testing of controls, the examiner should use professional judgment to determine the level of reliance that may be placed on the controls.

d. **Non-Statistical Sampling**

Non-statistical sampling is a technique designed to assist examiners with Phase 5 detail testing of dollar balances. Since this technique involves determining the accuracy of dollar balances, the concept of materiality applies. A common example of non-statistical sampling is testing reinsurance recoverable balances for existence and collectability.

A step-by-step approach has been provided below to assist examiners with non-statistical sampling.

1) **Describe the objective of the test.** The objective of the test should be defined, which usually includes determining whether an account balance or class of transactions is correctly stated.

2) **Define the population, population characteristics and an individual sampling unit.** The definition of the population should describe all possible items that will be included in the selection process. The examiner should also identify and document the source that the sample will be selected from including the report name. An individual sampling unit should describe the type of item available for selection. A specific definition is especially important in instances where sub-accounts or sub-totals are involved.
3) **Describe how completeness of the population was considered.** The examiner should determine that the population contains all appropriate items available to select in the sample. If the examiner is performing a detail test relating to an asset balance, a simple scanning or analytical review of the population should be sufficient to consider completeness.

However, if the examiner is performing a detail test relating to a liability balance, additional review and testing for completeness may be necessary. Completeness is an examination assertion that confirms that all transactions and events that should have been recorded have been recorded. The completeness assertion is particularly important for data used in the determination of liabilities because this assertion addresses understatement that could result from omitted items. As a result, the sample used to test completeness cannot be drawn from the population of recorded items being tested. In order to detect omitted items, the examiner should select items from an independent or reciprocal source of information related to the account being tested. Such sources include bank statements, physical policy or claim file inventories, or other sources noted during procedures within the planning process to understand the company and identify key functional activities. Since insurance companies are often highly automated, the examiner should be careful that the source selected is truly independent and not simply a differently formatted report from the database being tested.

4) **Determine individually significant items.** Determining the scope for individually significant items is a two-step process. First the examiner identifies tolerable error set during the calculation of planning materiality. In the worksheet (Part Two of Exhibit O), tolerable error is assumed to be 50% of Planning Materiality. Then the examiner should set a scope for individually significant items at a percentage of tolerable error. The worksheet automatically sets this scope by taking one-third (1/3) of the tolerable error amount. Any individual items that are over the calculated scope should be 100% tested and removed from the population. The 50% and 1/3 indicated above are generally used but may be adjusted by the examiner based on professional judgment. The worksheet (Part Two of Exhibit O) will automatically calculate the tolerable error and the scope for individually significant items after the examiner enters the planning materiality in the appropriate box.

Other items may be selected by the examiner for 100% testing based on their characteristics. For example, related-party transactions may not fall within the scope based on the calculations above but the examiner may want to test all related-party transactions. The examiner may also test any unusual balances or transactions deemed necessary.

After identifying individually significant items, and before proceeding with sampling from the remaining population, the examiner should use professional judgment to determine whether the individually significant items give the examiner sufficient evidence to mitigate the risk identified. If the examiner determines that there is no need to sample from the remaining population, this determination should be adequately documented in the examination workpapers and the remaining steps in this process would not be completed.

5) **Stratify the population (Part 1) and the sample (Part 2).** This step is performed in two separate parts. The first part of this step is stratifying the population and can be performed sequentially with the other steps. The second part of this step involves stratifying the sample and can be performed only after calculating the sample size in Step 7.

*Part 1 –* Based on the population’s characteristics, the examiner should determine whether the population should be stratified. Stratification is performed by dividing, separating or arranging items into subgroups, classes or buckets (strata). When using non-statistical sampling, every sampling unit within a particular stratum should have a chance of being selected. Stratification of the population would allow the examiner to select more sample items from the higher dollar stratum. The sampling population should be stratified so that the sample size can be related to the dollar size of each stratum. For example, more items can be selected from the stratum that consists of the top 1/3 of the sampling population.

*Part 2 –* As mentioned above, this part of the step should be performed after calculating the sample size in Step 7 has been completed. The examiner must stratify the total sample size into the strata. Individual items in each stratum can then be selected randomly, usually up to a proportion of the sample which roughly approximates the stratum’s proportion of the population. For example, if a sample is stratified where 70% percent of the total balance is in Strata A and the remaining 30% of the balance is in Strata B, approximately 70% of your selections should be
chosen from Strata A and 30% should be chosen from Strata B. In this example, if your calculated sample size equals 10, then 7 selections should be tested from Strata A and 3 selections should be tested from Strata B.

6) **Determine the assurance factor.** In order to accomplish this step, the examiner must know the assessment of the residual risk being tested. The examiner should also identify other Phase 5 exam procedures, such as analytical review procedures, that will provide assurance related to the residual risk identified. If an examiner is performing additional Phase 5 tests that have similar testing objectives, the level of reliance may be high or moderate, as long as few errors or issues were noted in that testing. Alternatively, if the examiner is not performing additional substantive testing for the same exam objectives, the degree of reliance would be low, thus increasing the sample size.

Use the following chart and find the intersection of residual risk and the level of reliance on other exam procedures to determine the assurance factor. The assurance factor will be used in Step 7 to help calculate a sample size.

<table>
<thead>
<tr>
<th>Residual Risk</th>
<th>Level of Reliance on Other Phase 5 Procedures</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Low</td>
</tr>
<tr>
<td>High</td>
<td>3.0</td>
</tr>
<tr>
<td>Moderate</td>
<td>2.3</td>
</tr>
<tr>
<td>Low</td>
<td>1.9</td>
</tr>
</tbody>
</table>

7) **Calculate the sample size.** The sample size is calculated as follows:

\[
\text{Sampling Population} \times \text{Assurance Factor} = \text{Sample Size}
\]

The sampling population is calculated by subtracting (1) Items to be tested 100%, (2) Items tested in other ways, and (3) Items not to be tested, from the total population amount. The tolerable error (usually 50% of Planning Materiality) was calculated in Step 4 above. The assurance factor was determined from the chart in Step 6 above. Use the equation to calculate the sample size based on these pre-determined factors.

Professional judgment should be used by the examiner to determine whether the calculated sample size is sufficient. The examiner should document the reasoning or justification for adjusting the sample size.

After the final sample size is calculated, the examiner should allocate the sample size among the sampling strata. The examiner should describe the basis of allocation and provide the sample breakdown for each stratum (this would be performed in Part 2 of Step 5 above).

8) **Select the sample and perform testing.** The sample should be selected in a way that is free from bias and representative of the entire population. Examiners should briefly explain the method they used to choose their selections and should also explain the stratification of the sample (if required). Once selections have been made, the examiner can proceed with testing.

9) **Determine the total error.** After the examiner has performed testing, the examiner should determine the total error. To do this, the examiner will use the errors found in the sample and calculate an error rate for each stratum. This error rate will then be applied to the entire stratum’s population to produce a projected error. For example, an examiner is testing a stratum of $100 and chooses to test a sample of $10 worth of these items. Through testing, the examiner identifies a $1 exception in the $10 worth of items tested (generating an error rate of 10%). The examiner would then apply this 10% error rate to the population of the strata to estimate a projected error of $10 in the $100 stratum. The examiner calculates the projected error for each stratum with the following equation:
The examiner should sum the projected errors for each stratum to accumulate the total projected error for the population. Considering that projected errors are estimates, examiners may wish to seek additional information or guidance before proposing an adjustment to the company.

10) Conclude on the acceptability of the test results. If deviations are discovered during testing, the examiner should ask the company to provide an explanation to help develop an understanding of the nature and extent of the deviations. The examiner should also understand how the test results affect other areas of the examination. If the company provides plausible explanations which indicate no chance of the error reoccurring, the examiner should document an explanation for why the selection should not be considered as an exception. If the company is unable to provide acceptable explanations for the deviations, then the results of the test must be rejected and the examiner should consider alternative procedures.

11) Perform alternative procedures (when results of a sampling test cannot be accepted). An examiner has several options when the results of a test cannot be accepted. After documenting the results of the test, the examiner may consider designing a different test to determine if the residual risk can be addressed through an alternate manner. The examiner can also ask the company to assist with additional testing. If concern remains after an examiner has exhausted all alternative options, the examiner should communicate this finding with other members of the exam team as the failed testing result may affect other areas of the exam. The examiner may also consider communicating the finding in the exam report or as a management letter comment, as appropriate.

e. Attribute Sampling

Attribute sampling is a method to estimate the deviation rate of a certain characteristic or attribute in a larger population. It is important to note that this deviation rate is not estimated as a monetary amount. Attribute sampling can be a tool for examiners to test the accuracy of items that are not quantifiable in dollars, such as the accuracy of non-monetary actuarial data elements (e.g. key dates, policy attributes, etc.). Examiners should use the following process to assist in detail testing attributes:

1) Determine the objective of the test. The objective of an attribute test is to verify that the desired attributes are present and accurate within the selected sample. Common objectives for which attribute sampling might be utilized include “Verify the accuracy and completeness of claims data” for P&C companies or “Verify the accuracy and completeness of in-force data used in formulating reserve calculations” for Life companies.

2) Define the period covered by the test.

3) Define the population, population characteristics and a sampling unit. The definition of the population should describe all possible items that will be included in the selection process. The examiner should also identify and document the source that the sample will be selected from, including the report name. A sampling unit should describe the type of item that is available for selection and will be subjected to testing.

4) Describe how the completeness of the population was considered. The examiner should determine that the population contains all appropriate items available to select in the sample. When possible, the examiner should confirm the completeness of the database through comparison to external sources. This can be accomplished by performing reconciliations to a reciprocal population, analytical procedures, or confirming that samples pulled from the reciprocal population are included in the database to be tested. Developing a test of completeness will vary from company to company and requires a solid understanding of the company and available data. Examiners should document their rationale and methods used to ensure completeness.

5) Define a deviation (error). A deviation in attribute sampling is an improper representation of an attribute from a sampling unit. A deviation could also be defined as a selection for which the company is unable to provide sufficient evidence of the attribute being tested. A deviation occurs when the attribute being examined is incorrect.
or the attribute being verified does not exist. A deviation or error that cannot be explained by the company is considered an exception.

6) **Determine Selection Technique.** Sample items should be selected in a manner that gives each item in the population an equal chance to be selected.

In particular circumstances it may be appropriate to stratify an attribute sampling population. For example, when testing the appropriateness of assumptions and methodologies utilized in determining the reserve amount, the examining actuary might request that the population be stratified by different lines of business or experience. Stratification may also be considered when a company has multiple computer systems for processing claims that consolidate into a company-wide reporting system for all claims. Since attribute sampling is not testing a dollar balance, it would be not be appropriate to stratify the population by dollar amount. Instead, the population should be segmented by some other characteristic that differentiates each transaction being tested (e.g. system used to process claims/transactions, line of business, etc.).

7) **Determine the Sample Size.** The examiner should use the level of residual risk assessed in Phase 4 to determine the sample size. For example, if the residual risk assessment in Phase 4 is moderate and no other Phase 5 procedures are being performed related to the risk identified, the examiner should use the corresponding column on the chart below to determine their sample size.

In determining the sample size, an examiner should use professional judgment to consider what reliance will be placed on audit work. The examiner should evaluate the sample size used by the auditors and determine if the sample size is reasonable based on the examiner’s professional judgment. The examiner should also consider the level of evidence selected by the auditors and the assessed level of residual risk. If the auditor’s desired level of evidence matches the residual risk level, the examiner may accept the results of the auditor’s testing with no additional selections or testing required. If the residual risk is higher than the level of evidence used by the auditors, the examiner may still leverage the audit work; however, the examiner will need to independently test additional selections so that the total sample size matches the chart below.

For populations with less than 250 items, the examiner should use professional judgment in determining the sample size and should also include a brief explanation of the rationale used to determine the sample size. Examiners may use the Test of Controls sampling chart as a reference for determining appropriate sample sizes.

For populations greater than 250 items, examiners may use the following chart to assist in determining Phase 5 attribute sample sizes:

<table>
<thead>
<tr>
<th>Determining a Sample Size</th>
</tr>
</thead>
<tbody>
<tr>
<td>Use the number of sampling units within the defined population and the desired level of evidence to determine your sample size.</td>
</tr>
</tbody>
</table>

*Assumes zero exceptions

<table>
<thead>
<tr>
<th>Number of Items in Population</th>
<th>Residual Risk</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Moderate (with reliance on other Phase 5 procedures)</td>
</tr>
<tr>
<td>Less than 250</td>
<td>Use Professional Judgment</td>
</tr>
<tr>
<td>250 or more</td>
<td>20</td>
</tr>
</tbody>
</table>

After selecting the proper sample size, perform the testing and determine the number of exceptions identified.

- **If 0 exceptions were identified:** The results of the test can be accepted. No further work is necessary.
- **If 1 exception was identified:** Additional testing is required. Use the chart below and add the corresponding number of selections to your original sample.
- **If 2 or more exceptions identified:** The examiner should discuss the exam findings with the company to determine the cause of the errors and consider alternative procedures.
Perform testing on the additional selections and determine the number of exceptions identified in the additional selections.

- **If 0 exceptions were identified in the additional selections:** The results of the test can be accepted. No further work is necessary.

- **If 1 or more exceptions were identified in the additional selections:** The examiner should discuss the exam findings with the company to determine the cause of the errors and consider alternative procedures.

8) **Conclude on the acceptability of the results.** When exceptions are found, it is important to understand the nature and cause of the exception. In attribute sampling the concept of materiality is not considered quantitatively. Examiners should communicate with the company to determine the source of the error and determine if similar errors are likely to exist. After the company provides an explanation for an exception, the examiner should use professional judgment to determine the amount of risk that still remains. If plausible and verifiable explanations are provided which indicate no chance of the error reoccurring, the examiner should document an explanation for why the selection should not be considered an exception. If the company is unable to provide acceptable explanations for the exceptions, the results of the test must be rejected and the examiner should consider alternative procedures. When the error affects input data for other examination items such as actuarial calculations, the error should be communicated to any examination team members who had planned to place reliance on the completeness and accuracy of the data.

9) **Perform alternative procedures (when results of a sampling test cannot be accepted).** An examiner has several options when the results of a test cannot be accepted. After documenting the results of the test, the examiner may consider designing a different test to determine if the residual risk can be addressed through an alternate manner. The examiner can also ask the company to assist with additional testing. If concern remains after an examiner has exhausted all alternative options, the examiner should communicate this finding with other members of the exam team as the failed testing result may affect other areas of the exam. The examiner may also consider communicating the finding in the exam report or as a management letter comment, as appropriate.

### D. Business Continuity

Reviewing an insurer’s business continuity plan is an established part of Financial Condition Examinations through testing and review performed in conjunction with the completion of the Information Technology Review. However, natural disasters, terrorism concerns and new business practices have led to a heightened need for management to plan for the prospective risks associated with business continuity including the risk to the financial solvency of the insurer. As such, business continuity planning has expanded beyond its initial information systems focus of disaster recovery plans to encompass issues such as natural and man-made disasters like terrorism, fraud, fire, loss of utility services, personnel losses and new laws and regulations. Therefore, it is important that an insurer’s business continuity plan be considered throughout all aspects of the examination and not just in the context of a review of the insurer’s information systems.

For all insurers, the business continuity process consists of identifying potential threats to an organization and developing plans to provide an effective response to ensure continuation of the company’s operations. The objectives of the business continuity process are to minimize financial losses; continue to serve policyholders and financial market participants; and to mitigate the negative effects disruptions can have on an insurer’s strategic plans, reputation, operations, liquidity, credit ratings, market position and ability to remain in compliance with laws and regulations. The guidance below provides examiners additional information about the business continuity process a typical insurance company may use. The guidance

<table>
<thead>
<tr>
<th>Number of Items in Population</th>
<th>Moderate (with reliance on other Phase 5 procedures)</th>
<th>Moderate (no reliance on other Phase 5 procedures)</th>
<th>High (with reliance on other Phase 5 procedures)</th>
<th>High (no reliance on other Phase 5 procedures)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Less than 250</td>
<td>Moderate</td>
<td>Moderate</td>
<td>High</td>
<td>High</td>
</tr>
<tr>
<td>250 or more</td>
<td>+10</td>
<td>+20</td>
<td>+30</td>
<td>+40</td>
</tr>
<tr>
<td>Total Sample Size</td>
<td>30</td>
<td>60</td>
<td>90</td>
<td>120</td>
</tr>
</tbody>
</table>

Use Professional Judgment

Add the amounts from this chart to your original sample size if 1 exception was identified.
does not create additional requirements for insurers to comply with, but should be used by examiners to assess the appropriateness of the company’s business continuity process.

Some of the basic steps all insurers would expect to have in their business continuity processes consist of:

1. Understanding the Organization

To develop an appropriate business continuity plan, an insurer must first understand its organization and the urgency with which activities and processes will need to be resumed in the event of a disruption. This step includes performing an annual business impact analysis and a risk assessment. The business impact analysis identifies, quantifies, and qualifies the business impacts of a disruption to determine at what point in time the disruption exceeds the maximum allowable recovery time. This point in time is usually determined separately for each key function of the insurer. The risk assessment reviews the probability and impact of various threats to the insurer’s operations. This involves stress testing the insurer’s business processes and business impact analysis assumptions with various threat scenarios. The results of the risk assessment should assist the insurer in refining its business impact analysis and in developing a business continuity strategy.

2. Determining Business Continuity Strategies

Under this step in the process, the insurer determines and selects business continuity management strategies to be used to continue the organization’s business activities and processes after an interruption. This step should use the outputs of step one above to determine what business continuity strategies the insurer will pursue. This includes determining how to manage the risks identified in the risk analysis process. The strategies should be determined at both the corporate and key functional level of the insurer.

3. Developing and Implementing a Business Continuity Plan

The purpose of the business continuity plan is to identify in advance the actions necessary and the resources required to enable the insurer to manage an interruption regardless of its cause. The plan should be a formal documentation of the insurer’s business continuity strategy and should be considered a “living document.” Some basic elements that should be included in a business continuity plan include:

- Crisis management and incident response
- Roles and responsibilities within the organization
- Recovery of all critical business functions and supporting systems
- Alternate recovery sites
- Communication with policyholders, employees, primary regulators and other stakeholders

The business continuity plan should be written and should include a step-by-step framework that is easily accessible and able to be read in an emergency situation.

4. Testing and Maintenance

A company’s business continuity plan cannot be considered reliable until it has been reviewed, tested, and maintained. The testing should be based on a methodology that determines what should be tested, how often the tests should be performed, how the tests should be run and how the tests will be scored. It is recommended that key aspects of the plan be tested annually and that the test be based on clear objectives that will allow the results of the test to be scored to determine the effectiveness of the business continuity plan. In addition to testing the plan, the plan should be maintained and updated regularly to ensure that the organization remains ready to handle incidents despite internal and external changes that may affect the plan.
Examiner Review of Business Continuity Plans

Reviewing the insurer’s business continuity plan is a vital part of assessing a company’s prospective risk. When evaluating the company’s business continuity plan, the examiner should first become familiar with the work completed on the insurer’s business continuity plan during the review of the company’s information systems, which may include reviewing the insurer’s business continuity plan to determine any of the following:

- Whether the plan is current, based on a business impact analysis, tested periodically and developed to address all significant business activities;
- Whether the business continuity plan clearly describes senior management’s roles and responsibilities associated with the declaration of an emergency and implementation of the plan;
- Whether a list of critical computer application programs, data and files has been included in the plan;
- Whether a restoration priority has been assigned to all significant business activities;
- Whether user departments have developed adequate manual processing procedures for use until the electronic data processing function can be restored;
- If copies of the plan are kept in relevant off-site locations;
- If current backup copies of programs, essential documents, records and files are stored in an off-premises location;
- Whether a written agreement or contract exists for use by IT of a specific alternate site and computer hardware to restore data processing operations after a disaster occurs; and
- Whether the business impact analysis is periodically reviewed to determine the appropriateness of maximum recovery times.

After the examiner has become familiar with the work completed on the insurer’s business continuity plan during the review of the information systems, the examiner should consider what additional work should be performed to determine whether the insurer has established an appropriate business continuity plan. Examples of additional procedures that may need to be performed include the following:

- Determine if the board has established an appropriate enterprise-wide business continuity planning process and if the board reviews and approves the business continuity plan on an annual basis.
- Determine if senior management periodically reviews and prioritizes each business unit, department, and process for its critical importance and recovery prioritization.
- Determine if senior management has evaluated the adequacy of the business continuity plans of its service providers and whether the capabilities of the service provider are sufficient to meet the insurer’s maximum recovery times.
- Review the business continuity plan to determine whether the plan takes into account business continuity risks not related to information technology such as public relations, human resource management and other factors.
- Perform additional procedures as necessary based on the risks of the insurer being examined.

E. Using the Work of a Specialist

1. Decision to Use the Work of a Specialist

Education and experience enable the examiner to be knowledgeable about insurance matters in general, but the examiner is not expected to have the expertise of a person trained for or qualified to engage in the practice of another profession or occupation. During the examination, an examiner may encounter matters potentially material to the current or prospective solvency of the insurer that require special knowledge and, in the examiner’s judgment, require using the work of a specialist. The department should have on staff or be able to contract the requisite expertise to effectively examine any insurer. The requisite expertise should be determined by the character and nature of the domestic industry.

Examples of matters that may necessitate the work of a specialist include, but are not limited to, the following:

a. IT Review and assessment of applications (e.g., EDP environment and controls, computer audit techniques and expert systems).
b. Valuation of invested assets and portfolio analysis (e.g., real estate, restricted securities and other complex investment holdings).

c. Determination of amounts derived and risks associated with specialized techniques or methods (e.g., certain actuarial determinations, pricing and liquidity).

d. Interpretation of technical requirements, regulations, or agreements (e.g., the potential significance of reinsurance and other contracts or other legal documents, or legal title to property).

In certain situations, an examination requires the use of a specialist to effectively examine an insurer. These situations include the following:

a. Life and Health company examinations where the company has a substantial amount of interest-sensitive business or with a substantial amount of business subject to principle-based reserve (PBR) calculations or exclusion tests require the involvement of a credentialed actuary to perform an evaluation of reserves.

b. Property & Casualty company examinations where the company has a substantial amount of long-tail lines of business require the involvement of a credentialed actuary to perform an evaluation of loss reserves.

In all other situations, the decision to use a specialist is at the discretion of the examination team in consultation with the chief examiner or designee.

2. Selecting a Specialist

The department should obtain satisfaction concerning the professional qualifications and reputation of an outside specialist by inquiry or other procedures, as appropriate. The department should consider the following:

a. The professional certification, license, or other recognition of the competence of the specialist in his/her field, as appropriate.

b. The reputation and standing of the specialist in the views of his/her peers and others familiar with his/her capability or performance.

c. The relationship, if any, of the specialist to the company.

d. Prior experience of the specialist in working on examinations.

3. Determining the Involvement of and the Work to be Performed by the Specialist

Typically, the use of a specialist should be determined during examination planning, preferably well in advance of fieldwork. An understanding should exist among the department, including the examiner-in-charge, the company and the specialist about the nature of the work to be performed by the specialist. This understanding should be documented in the Exam Planning Memorandum by covering the following:

a. The specialists’ role in the risk assessment process, including interviews, selection of key activities and the development of risk statements.

b. The planned objectives and scope of the specialists’ work.

c. The specialists’ representations as to their relationship, if any, to the company.

In certain situations, it may be difficult to determine that a specialist is needed prior to performing risk assessment procedures. In these cases, the exam team may still elect to involve a specialist by adequately documenting the rationale for this decision in the examination workpapers without amending the Exam Planning Memorandum.
4. Documentation of Work Performed by the Specialist

The examiner-in-charge should communicate with the specialist as to the appropriate documentation of the work performed by the specialist. It should be determined upfront with the specialist who is responsible for the completion of the risk matrix and supporting documentation. Regardless of who is responsible for completing the risk matrix in a particular area, the work performed is required to clearly document a consideration of all seven phases of the risk-focused examination process. The work should also be completed in accordance with the guidance outlined in the standard examination procedures regarding examination documentation, including sufficient documentation on all conclusions.

5. Review and Use of the Findings of the Specialist

Although the appropriateness and reasonableness of the work performed is the responsibility of the specialist, the examiner-in-charge should obtain an understanding of the work performed by the specialist to determine whether the findings are suitable to meet the needs of the examination. This requires the examiner-in-charge to review the work completed by the specialist and to understand the nature and impact of any findings or exceptions identified by the specialist. This review should be demonstrated via sign-off on all significant workpapers and procedure steps completed by the specialist. In addition, the examiner-in-charge is responsible for incorporating these findings into the examination report, management letter or ongoing supervisory plan of the insurer, but may request the assistance of the specialist in developing these items.

6. Additional Considerations for Commonly Used Specialists

**IT Specialist**

The use of an IT specialist in performing an IT Review should be considered for all multi-state examinations. However, examinations of less-complex IT systems or systems where extensive test documentation is already available (e.g., external audit work, SSAE 18 reports, etc.) may minimize the need to involve an IT specialist. When selecting IT specialists, the examination team should keep in mind designations indicating that specialists have met specific training and educational requirements, such as CISA, AES, CITP, CRISC, etc. For more guidance on the use of an IT specialist during an examination, see Section 1 Part III A on General Information Technology Review.

**Reinsurance Specialist**

The use of a reinsurance specialist should be considered for examinations of insurers with complex and sophisticated reinsurance programs. Scenarios under which it may be appropriate to utilize a reinsurance specialist include but are not limited to the following:

- The reinsurance program includes restrictions on levels and concentrations of reinsurance that do not appear normal;
- Excessive bonus or other unusual remuneration or incentives for management are tied to the performance of reinsurance contracts;
- The insurer utilizes off-balance-sheet vehicles including structured investment vehicles and special purpose vehicles for reinsurance purposes;
- The entity holds a significant amount of reinsurance-related reserves in comparison to its overall reserves and policyholder surplus;
- The insurer carries a significant amount of reinsurance balances that demonstrate questionable characteristics (e.g., overdue, disputed, concentrations, etc.); and
- For property and casualty insurers, the entity responded affirmatively to General Interrogatories – Part 2: 7.1, 8.1, 9.1, 9.2 or 9.4.
When selecting reinsurance specialists, the examination team should keep in mind designations indicating that specialists have met specific training and educational requirements, such as ARe, ARA, etc. For more guidance on specific reinsurance review procedures during an examination, see Section 1 Part V.

**Actuarial Specialist**

As previously noted, the involvement of a credentialed actuary is required on all examinations of life and health insurers with a substantial amount of interest-sensitive business, with a substantial amount of business subject to principle-based reserve (PBR) calculations or subject to PBR exclusion tests and property/casualty insurers with a substantial amount of long-tail lines of business. Actuarial credentials include Fellow (or Associate) of the Casualty Actuarial Society (FCAS/ACAS) for property and casualty lines as well as Fellow (or Associate) of the Society of Actuaries (FSA/ASA) or Member of the American Academy of Actuaries (MAAA) for life and health lines. In addition to situations where the use of a credentialed actuary is required, there are many other situations in which the use of an actuarial specialist would be appropriate, such as pricing, liquidity, and reinsurance risk. Therefore, it is recommended that considerations regarding the use of an actuarial specialist be documented on all multi-state examinations. In addition to the use of credentialed actuaries, other individuals may be considered for use as actuarial specialists if they have training, experience and education providing them with an appropriate background for this role. This may include individuals in the process of obtaining actuarial credentials (e.g., completed some of the actuarial exams) with degrees in actuarial science, mathematics and statistics. The NAIC’s support staff will be available to provide actuarial expertise and/or be consulted as to whether the use of an actuarial specialist would be appropriate to the circumstances.

**Investment Specialist**

The use of an investment specialist should be considered for examinations of insurers with complex investment portfolios. Scenarios under which it may be appropriate to utilize an investment specialist include but are not limited to the following:

- The insurer maintains a significant position greater than its competitors’ averages in any of the following investment categories:
  - Bonds with call options and varied payment timing
  - Foreign investments
  - Hybrid capital securities
  - Mezzanine loans
  - Affiliated investments
  - RMBS, CMBS, ABS CO/CLO or similar bond collateral types
  - Structured securities on negative watch
- The insurer participates in derivative trading;
- The insurer participates in securities lending, repurchase and reverse repurchase transactions; and
- The insurer has significant exposure to liquidity and asset/liability matching risks.

Investment specialists generally have one or more designations indicating they have completed the specific training and educational requirements, including IPIR, FRM, CIMA, CFA, etc.

7. **Controlling Exam Costs When Utilizing the Work of an Outside Specialist**

When the examiner utilizes the work of outside specialists, exam costs may rise. The examiner should have sufficient oversight of the specialist’s work to minimize the examination costs. As the procedures for utilizing specialists and independent contractors are similar, refer to Part 3 of this Handbook section, “Use of Independent Contractors on Multi-State Examinations,” for more details on how to control costs when utilizing the work of a specialist.
F. Outsourcing of Critical Functions

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

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

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

Types of Service Providers

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

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

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

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

- **Custodian** – A national bank, state bank, trust company or broker/dealer which participates in a clearing corporation.
SECTION 1 – GENERAL EXAMINATION GUIDANCE

General Considerations

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

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

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

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

Managing General Agents

Specific qualifications and procedures for managing general agents (MGAs) to follow are outlined in the NAIC’s Managing General Agents Act (Model #225). The examiner should consider performing the following steps to ensure that risks in this area have been appropriately mitigated when examining an insurer that utilizes MGAs:

1. Review the licenses of all MGAs:
   a. Note the effective and expiration dates of licenses; and
   b. Note if each MGA is licensed to represent the insurer domiciled in this state.

2. Review all contracts between MGAs and insurance companies:
   a. Each contract must contain a clause that the insurance company may cancel the contract for any reason, upon written notice to the MGA;
   b. Note the limitations each contract places on the MGA with respect to amount of risk insured, geographical location of risk or any other limitations detailed in contract; and
   c. The contract should specifically prohibit the MGA from binding the insurance company to any reinsurance.

3. Sample policies produced by each MGA:
   Each policy must fall within the financial and geographical limitations imposed by each contract with the respective insurance companies.

4. Sample financial accounts submitted by the MGA:
   a. All accounts must be submitted quarterly and within a reasonable amount of time after the end of each quarter; and
   b. All accounts should be in a format and contain such information that will enable an insurance company to use the accounts to properly complete its annual statement.

5. Review internal controls over cash transactions between insurance companies and MGAs:
   a. All funds collected by the MGA on behalf of the insurance company must be deposited in a separate fiduciary account in a bank that is a member of the Federal Reserve System. This account should be owned and controlled by the insurance company;
   b. All funds owed to the insurance company by the MGA should be paid on a timely basis; and
c. The MGA may retain no more than three months worth of loss and allocated loss expense payments in the fiduciary account owned and operated by the insurance company.

6. Review the insurance company’s procedures for monitoring each MGA’s activities:
   a. The insurance company should obtain, at least annually, a certified public accountant’s report on the business produced by each MGA as well as an opinion of an actuary attesting to the adequacy of loss reserves on business produced by each MGA;
   b. The insurance company should periodically conduct an audit of each MGA’s operations; and
   c. The insurance company should make sure that only an officer of the company, who is not affiliated with an MGA, has the authority to bind the insurer to any reinsurance on any participation with syndicates.

Insurance Producers

An insurance producer sells, solicits or negotiates insurance on behalf of an insurer and receives compensation or commission. Individuals who are officers, directors, employees and subsidiaries, or affiliates of a company, who do not receive commission from policies written or sold and perform duties unrelated or only indirectly related to the sale, solicitation or negotiation of insurance, are not considered to be insurance producers. Individuals or business entities practicing as insurance producers must maintain a resident or nonresident producer license, when mandated by state law. In order to receive an insurance producer license, individual applicants must pass a written examination that tests the following: the lines of authority for which application is made, the duties and responsibilities of insurance producers and the state’s insurance laws and regulations.

Insurance producers may receive a license in one or more of the following lines of authority or in any other insurance type permitted under state law:

- Life
- Accident and Health or Sickness
- Property and Casualty
- Variable Life or Variable Annuity Products
- Personal Lines
- Credit

Once an individual or company receives an insurance producer license, the license will remain in effect, unless revoked or suspended, as long as the correlating fees are paid and education requirements are met. Licensed producers are maintained on the NAIC’s Producer Database.

If insurance producers violate the governing provisions in the NAIC’s Producer Licensing Model Act (Model #218), the insurance commissioner may terminate, suspend, or non-renew the insurance producer license. Insurance commissioners may also levy civil penalties against insurance producers if considered necessary.

Notification should be provided to the commissioner when insurers terminate relationships (i.e., agency contracts) with insurance producers either with or without cause. The insurer is required to provide information to the commissioner, if requested, regarding the relationship termination and activity of the producer.

HMO Producers

Health Maintenance Organizations (HMOs) are also permitted to have insurance producers if appropriately licensed. To receive an HMO insurance producer license, in addition to the basic requirements of insurance producers, the HMO producer is required to demonstrate financial responsibility and the reasonable protection of customers. The HMO producer usually completes this requirement by issuing bonds, deposits or other means as specified by the department. Like insurance producers, the license of a HMO producer can be denied, suspended or terminated by the state department.
If required by the state, HMO licensed producers shall be appointed to solicit, negotiate, procure or renew HMO membership contracts on behalf of a HMO. Notification of HMO producer appointments is required to be communicated to the state’s insurance department. Termination of HMO appointments may occur upon written notification to the state insurance department by either the HMO producer or the HMO.

**Controlling Producers and Controlled Insurers**

Controlling producers are licensed producers, (see above) who through contracts are able to directly and/or indirectly influence the direction of the controlled insurers management and policies. As with insurance producers, controlling producers receive compensation, commission, or other forms of monetary payment from controlled insurers in return for soliciting, negotiating, or procuring insurance contracts on behalf of the insurer. According to the NAIC’s *Business Transacted with Producer Controlled Property/Casualty Insurer Act* (Model #325), controlling producers who provide gross written premiums equal to or greater than 5% of the controlled insurer’s admitted assets as reported on the controlled insurer’s quarterly statement filed as of September 30 of the prior year, are generally required to maintain compliance with specific contract guidelines, obtain requisite commissioner approval, and provide disclosure to the insured prior to the policy’s effective date. Failing to comply with the established requirements may result in the commissioner terminating the relationship between the controlling producer and the controlled insurer and civil action to impose compensatory damages for the insurer or policyholder.

1. **Requirements of Controlling Producers and Controlled Insurers**

   Contracts between controlling producers and controlled insurers are required to be in writing, contain specific contract provisions if deemed necessary, and be approved by the insurers board of directors. Furthermore, the controlled insurer’s audit committee is required to be comprised of independent directors who annually meet with management, CPAs, and casualty actuaries and/or loss reserve specialists to review the sufficiency of the insurer’s loss reserves. The findings of the reserve specialists, with regards to the loss ratios and loss reserves established for incurred and outstanding losses for business placed by the producer, has to be reported to the controlled insurer’s commissioner by April 1 every year. In order to verify that the controlling producer is not receiving unduly high commissions, the commissioner must also receive detail of the commissions paid and the percentage of the respective paid commissions to the net premiums written, along with comparable data for non-controlling producers placing the same type of business.

2. **Specific Contract Provisions**

   Specific contract provisions between the controlling producer and the controlled insurer are required if the controlling producer meets the 5% written premium threshold as previously indicated. However, the specific contract provisions are not required if the controlling producer does not receive compensation based on the amount of premiums written, or the controlled insurer accepts insurance business only from a controlling producer.

   The specific contract provisions are as follows:

   a. Upon written notice to the controlling producer, the controlled insurer may terminate the contract for cause. The controlled insurer is entitled to suspend the controlling producer’s authority to write business during the duration of any dispute regarding the cause for the termination.

   b. The controlling producer shall render accounts including detail of all material transactions to the controlled insurer. This includes information necessary to support all commissions, charges and other fees received by, or owed to, the controlling producer.
c. The controlling producer shall remit all funds due under the terms of the contract to the controlled insurer on at least a monthly basis. Additionally, premiums or installments collected by the controlling producer shall be remitted no later than 90 days after the effective date of a policy placed with the controlled insurer.

d. The controlling producer shall hold all funds collected on behalf of the controlled insurer in a fiduciary capacity, in banks that are members of the Federal Reserve System, and in appropriately identified bank accounts.

e. Separate, identifiable records of business written for the controlled insurer shall be maintained by the controlling producer.

f. The controlling producer shall not assign the contract in whole or in part.

g. The controlled insurer shall provide the controlling producer with its underwriting standards, rules and procedures, manuals setting forth the rates to be charged, and the conditions for the acceptance or rejection of risks. The controlling producer shall adhere to the standards, rules, procedures, rates and conditions. The standards, rules, procedures, rates and conditions shall be the same as those applicable to comparable business placed with the controlled insurer by a producer other than the controlling producer.

h. The contract shall specify the rates and terms of the controlling producer’s commissions, charges or other fees and the purposes for those charges or fees. The rates of the commissions, charges and other fees shall not be greater than those applicable to non-controlling producers for comparable business (i.e., same kinds of insurance and risks, similar policy limits, and quality of business) placed with the controlled insurer.

i. Controlling producer compensation based on insurer profits shall not be determined or paid until at least five years after the premiums on liability insurance are earned and at least one year after the premiums are earned on any other type of insurance. Commissions shall not be paid until an independent casualty actuary or loss reserve specialist has confirmed the sufficiency of the controlled insurer’s reserves on remaining claims, including incurred but not reported (IBNR).

j. The contract shall specify a percentage limit of writings the controlling producer is entitled to make relative to the controlled insurer’s surplus and total writings. The insurer may establish a different limit for each line or sub-line of business. Notification by the controlled insurer to the controlling producer is required when the established limit is approached. Once the limit has been reached, the controlled insurer is prohibited from accepting business from the controlling producer. The controlling producer shall not attempt to place business with the controlled insurer if it has been notified that the limit has been reached.

k. The controlling producer may bind facultative reinsurance contracts pursuant to obligatory facultative agreements if the contract with the controlled insurer contains underwriting guidelines for assumed and ceded business that includes a list of reinsurers with which automatic agreements are in effect, the coverages and amounts or percentages that may be reinsured, and commission schedules. Otherwise, for business placed by the producer, the controlling producer is entitled to negotiate but is unable to bind reinsurance on behalf of the controlled insurer.

Custodial or Safekeeping Agreements

Specific requirements related to an insurance company’s utilization of systems for holding and transferring securities are included in the NAIC’s Model Act on Custodial Agreements and the use of Clearing Corporations (Model #295) and the NAIC’s Model Regulation on Custodial Agreements and the use of Clearing Corporations (Model #298). When conducting financial examinations, the custodial or safekeeping agreements should be considered and evaluated with this guidance.

1. An insurance company may, by written agreement, provide for the custody of its securities with a custodian. If permitted by the state of domicile, the custodian must either be a broker/dealer that is registered with and subject to jurisdiction of the Securities and Exchange Commission, maintains membership in the Securities Investor
Protection Corporation, and has a tangible net worth equal to or greater than $250,000,000; or a national bank, federal home loan bank, or trust company which is adequately capitalized and qualified to accept securities as determined by the standards adopted by the U.S. banking regulators and regulated by state banking laws or a member of the Federal Reserve system. Custodial agreements shall be authorized by a resolution on behalf of the board of directors or an authorized committee of the insurance company. The agreement should state that certificated securities of the insurance company shall be held separate from all other securities. Those securities held indirectly by a custodian or in a clearing corporation shall be separately identified on the custodian’s official records as being owned by the insurance company. Registered custodial securities shall be registered in the name of the company, in the name of a nominee of the company, in the name of the custodian or its nominee, or clearing corporation or its nominee. The securities, other than those held to meet deposit requirements, shall be held subject to the instructions of the insurance company, and shall be withdrawable upon the demand of the insurance company. Confirmation of all transfers should be provided to the insurance company in hardcopy or in electronic format.

2. Custodial or safekeeping agreements with an agent, or clearing corporation meeting the requirements herein should contain satisfactory safeguards and controls, including but not limited to the provisions provided below. For the purpose of this guidance, an agent is a national bank, federal home loan bank, trust company or broker/dealer with an account in a clearing corporation, or a member of the Federal Reserve System. A clearing corporation is a corporation as defined in Article 8 of the Uniform Commercial Code that is organized for the purpose of effecting transactions in securities by computerized book-entry, including the Treasury/Reserve Automated Debt Entry Securities System (TRADES) and Treasury Direct book entry securities systems, except those securities issued under the laws of a foreign country.

a. The custodian is obligated to indemnify the insurance company for any insurance company’s loss of securities in the custodian’s custody, except that, unless domiciliary state law, regulation or administrative action otherwise require a stricter standard (Section 2.b. sets forth an example of such a stricter standard), the custodian shall not be so obligated to the extent that such loss was caused by other than the negligence or dishonesty of the custodian;

b. If domiciliary state law, regulation or administrative action requires a stricter standard of liability for custodians of insurance company securities than that set forth in Section 2.a., then such stricter standard shall apply. An example of a stricter standard that may be used is that the custodian is obligated to indemnify the insurance company for any loss of securities of the insurance company in the custodian’s custody occasioned by the negligence or dishonesty of the custodian’s officers or employees, or burglary, robbery, holdup, theft, or mysterious disappearance, including loss by damage or destruction;

c. In the event of a loss of the securities for which the custodian is obligated to indemnify the insurance company, the securities shall be promptly replaced or the value of the securities and the value of any loss of rights or privileges resulting from said loss of securities shall be promptly replaced;

d. The custodian shall not be liable for any failure to take any action required to be taken hereunder in the event and to the extent that the taking of such action is prevented or delayed by war (whether declared or not and including existing wars), revolution, insurrection, riot, civil commotion, act of God, accident, fire, explosions, stoppage of labor, strikes or other differences with employees, laws, regulations, orders or other acts of any governmental authority, or any other cause whatever beyond its reasonable control;

e. In the event that the custodian gains entry in a clearing corporation through an agent, there should be a written agreement between the custodian and the agent that the agent shall be subjected to the same liability for loss of securities as the custodian. If the agent is governed by laws that differ from the regulation of the custodian, the Commissioner of Insurance of the state of domicile may accept a standard of liability applicable to the agent that is different from the standard liability;

f. If the custodial agreement has been terminated or if 100% of the account assets in any one custody account have been withdrawn, the custodian shall provide written notification, within three business days of termination or withdrawal, to the insurer’s domiciliary commissioner;
g. During regular business hours, and upon reasonable notice, an officer or employee of the insurance company, an independent accountant selected by the insurance company and a representative of an appropriate regulatory body shall be entitled to examine, on the premises of the custodian, its records relating to securities, if the custodian is given written instructions to that effect from an authorized officer of the insurance company;

h. The custodian and its agents, upon reasonable request, shall be required to send all reports which they receive from a clearing corporation, which the clearing corporation permits to be redistributed including reports prepared by the custodian’s outside auditors, to the insurance company on their respective systems of internal control;

i. To the extent that certain information maintained by the custodian is relied upon by the insurance company in preparation of its annual statement and supporting schedules, the custodian agrees to maintain records sufficient to determine and verify such information;

j. The custodian shall provide, upon written request from a regulator or an authorized officer of the insurance company, the appropriate affidavits, with respect to the insurance company’s securities held by the custodian;

k. The custodian shall secure and maintain insurance protection in an adequate amount; and

l. The foreign bank acting as a custodian, or a U.S. custodian’s foreign agent, or a foreign clearing corporation is only holding foreign securities or securities required by the foreign country in order for the insurer to do business in that country. A U.S. custodian must hold all other securities.

3. Except as provided below, the examiner shall verify such securities by actual inspection and count and whenever necessary ascertain whether the securities are the specific ones acquired by the company:

a. Securities on deposit with state officials need not be counted (provided) if a certificate of verification is secured directly from the custodian or insurance commissioner.

b. Where domiciliary state law, regulation, or administrative action does not prohibit the use of custodial arrangements under which actual inspection or count of specific securities acquired is not possible, and the insurance company uses such an arrangement, the examiners shall:

   • Apply the provisions of Sections d. and g. below, in cases where the custodian, under the controlling custodial or safekeeping agreement, is permitted to carry securities indirectly or otherwise commingled form;

   • Apply the provisions of Sections e. and g. below, in cases where the custodian, under the controlling custodial or safekeeping agreement, directly or indirectly participates in the Treasury Reserve Automated Debt Entry Securities System (TRADES) or Treasury Direct system. These systems are computerized programs sponsored by the United States department of the Treasury and certain agencies and instrumentalities of the United States for holding and transferring securities of the United States government and the agencies and instrumentalities, respectively, in Federal Reserve Banks through banks which are members of the Federal Reserve System or which otherwise have access to such computerized systems; and

   • Apply the provisions of Section f. and g. below, in cases where the facilities of a clearing corporation are used, either directly or indirectly through a custodian, under the controlling custodial or safekeeping agreement.
c. Securities held by a custodian under other custodial or safekeeping arrangements need not be counted, at the discretion of the examiner-in-charge, if the following criteria are met (provided the domiciliary state laws do not require that such securities be counted and inspected during an examination):

- Examiners are furnished a copy of the custodial or safekeeping agreements;
- They are satisfied such agreement has the necessary safeguards and controls;
- The securities are held by a custodian licensed by the United States or any state thereof, and such custodian is regularly examined by the applicable licensing authority;
- The securities so deposited are at all times kept separate and apart from other deposit accounts with the custodian, so that at all times they may be identified as belonging solely to the company for which they are held;
- If such a deposit is not counted, a verification certificate signed by an authorized signatory of the custodian holding the deposit shall be secured by the examiners directly;
- Such certificate shall be in sufficient detail to permit adequate identification of the securities; and
- Such certificate may be accepted in lieu of actual count provided it meets the above requirements and the examiners are satisfied that the representation thus made is in accordance with the facts.

d. Where not prohibited by domiciliary state law and if permitted by the terms of the controlling custodial or safekeeping agreement containing satisfactory safeguards and controls, securities held by a custodian that meets the requirements of Section c. above, may be held by the custodian, in bulk as a part of a “jumbo” certificate, or other system under which there is a commingling of securities held in custody. In such cases, the examiners shall:

- Obtain directly from the custodian a certified listing of the securities held as of the date of examination for the account of the insurance company under examination;
- Obtain a copy of the insurance company’s listing of the securities held by the custodian for the insurance company’s account as of the date of examination; and
- Match the positions shown on the custodian’s listing to the positions shown on the company’s listing, and reconcile any differences.

e. Custodians which meet the requirements of Section c. above, and which either are members of the Federal Reserve System or non member banks redepositing securities with a member bank, may, when acting as custodians for insurance companies, use the Treasury/Reserve Automated Debt Entry Securities System (TRADES) or the Treasury Direct book entry securities systems under a written agreement with the insurance company permitting such utilization. In such cases, the examiners shall follow the procedures set forth in Section c. above.

f. Where not prohibited by domiciliary state law, an insurance company may, under a written agreement, use the facilities of a clearing corporation, either directly or through a custodian, subject to the requirements of Section c. above. In such cases, the examiners shall:

- Obtain directly from the depository if direct deposit is used, or from the custodian if indirect deposit is used, a certified listing of the securities held in the clearing corporation as of the date of examination for the account of the insurance company under examination;
General Considerations

- Obtain a copy of the insurance company’s listing of its securities held by the clearing corporation as of the date of examination;

- Match the positions shown on the clearing corporation’s or custodian’s listing to the positions shown on the company’s listing, and reconcile any differences; and

- Ascertain that the securities are held by a clearing corporation regulated by the Securities and Exchange Commission, the Federal Reserve System, or the banking authorities in its state of domicile.

g. In carrying out their responsibilities under Section d, e, and f above, it is important that the examiners satisfy themselves as to the integrity of the accounting controls and verification and security procedures of the custodian and/or the clearing corporation, as the case may be. This satisfaction may be obtained by securing the most recent report on the review of the custodian’s system of internal controls pertaining to custodian record keeping issued by the respective organization’s independent auditors.

**Investment Advisers**

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

Key information provided on a Form ADV includes:

a. Locations in which the adviser/broker is registered

b. Information about the advisory business including size of operations and types of customers (Item 5)

c. Information about whether the company provides custodial services (Item 9)

d. Information about disciplinary action and/or criminal records (Item 11)

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

Where not prohibited by domiciliary state law and if permitted by the investment adviser agreement, there may be situations in which the investment adviser also acts as a custodian. In these instances, investment advisers are required to obtain an annual examination by an independent public accountant to verify compliance with custodial responsibilities as provided in the federal Investment Advisers Act of 1940 and/or the federal Investment Company Act of 1940. The accountant’s report is also available on the Form ADV.

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

a. Selection of Investments
   It should be clear from the advisory agreement, how the investment adviser will select investments. This should include specific reference to the insurer’s investment strategy.

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

c. Conflicts of Interest
   To the extent that any conflicts of interest may be known to the insurer, the advisory agreement should specifically indicate the manner in which such conflicts will be considered. This is an important protection against an investment adviser’s biases as a result of business arrangement (e.g. referral relationships, affiliate product offerings, etc.) that may interfere with the proper execution of the investment strategy. For example, investment advisers often have affiliates that offer investment options that should be available to the insurer but should not be given preferential treatment if competitor products are determined to be a better fit for the selected investment strategy.

d. Fiduciary Responsibility
   Language provided in the investment management agreement should acknowledge the investment adviser’s role as a fiduciary in advising the insurer. This is an important legal distinction that may help protect the insurer’s interests in the execution of the company’s investment strategy.

e. Calculation of Fees
   It is important that the manner in which fees are calculated is well defined in the management agreement and that the structure of the fee is considered as management assesses the adviser’s performance. For example, if the advisory fee is computed based on volume of transactions, it would be important for management to closely review the frequency of trades to help avoid excessive charges.

f. Review of Performance
   Agreements should include consideration of information that will be provided to the company to permit the company to perform adequate review of the adviser’s performance and execution of the investment strategy.

There may be other terms that examiners consider to be significant and can therefore tailor their review based on judgment and the specifics of the insurer under exam.

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

**Affiliated Service Providers**

Specific requirements related to an insurance company’s utilization of cost sharing services and management services with affiliates are included in the NAIC’s *Insurance Holding Company System Model Regulation* (Model # 450). Prior to entering into one of these agreements, an insurer must first give notice to the State Insurance Department of the proposed transaction via the Form D filing. As the receipt and review of the Form D filing is typically the responsibility of the Department Analyst, the examiner should leverage that review to the extent possible. If the agreement has not been obtained and reviewed by the analyst, or if significant agreements have not been modified since 12/31/14 (date that new provisions were effective in Model #450), the examiner should obtain and evaluate whether the agreement includes the provisions listed below:
General Considerations

Agreements for cost sharing services and management services shall at a minimum and as applicable:

1. Identify the person providing services and the nature of such services;

2. Set forth the methods to allocate costs;

3. Require timely settlement, not less frequently than on a quarterly basis, and compliance with the requirements in the Accounting Practices and Procedures Manual;

4. Prohibit advancement of funds by the insurer to the affiliate except to pay for services defined in the agreement;

5. State that the insurer will maintain oversight for functions provided to the insurer by the affiliate and that the insurer will monitor services annually for quality assurance;

6. Define books and records of the insurer to include all books and records developed or maintained under or related to the agreement;

7. Specify that all books and records of the insurer are and remain the property of the insurer and are subject to control of the insurer;

8. State that all funds and invested assets of the insurer are the exclusive property of the insurer, held for the benefit of the insurer and are subject to the control of the insurer;

9. Include standards for termination of the agreement with and without cause;

10. Include provisions for indemnification of the insurer in the event of gross negligence or willful misconduct on the part of the affiliate providing the services;

11. Specify that, if the insurer is placed in receivership or seized by the commissioner under the State Receivership Act:
   a. all of the rights of the insurer under the agreement extend to the receiver or commissioner; and,
   b. all books and records will immediately be made available to the receiver or the commissioner, and shall be turned over to the receiver or commissioner immediately upon the receiver or the commissioner’s request;

12. Specify that the affiliate has no automatic right to terminate the agreement if the insurer is placed in receivership pursuant to the State Receivership Act; and

13. Specify that the affiliate will continue to maintain any systems, programs, or other infrastructure notwithstanding a seizure by the commissioner under the State Receivership Act, and will make them available to the receiver, for so long as the affiliate continues to receive timely payment for services rendered.

If certain provisions are missing from affiliate service agreements, the examination team should encourage/require revisions to include all appropriate provisions, depending upon the date of the agreement and provisions required by Model #450 at that date. In addition, in accordance with the risk-focused examination process and utilizing guidance from the Related Party Repository, the examiner should consider whether terms of significant affiliated agreements are fair and equitable. Examiners should also note that additional guidance for reviewing individual affiliated transactions is located in Section 1, Part IV D in this Handbook.

Other Third-Party Administrators (TPAs)

In addition to using third-parties as managing general agents, producers, controlling producers, investment advisers, investment custodians, and affiliated service providers, third-parties can be used to perform a number of other functions for
the insurer. These functions may include payroll processing, claims review, claims processing, premium processing, investment management, reinsurance program management or general IT processes. Depending upon legislative and/or regulatory action in each state, TPAs performing these services in connection with life, annuity, health or worker’s compensation coverage provided by an insurer may be subject to requirements as outlined in the NAIC’s Registration and Regulation of Third Party Administrators (Guideline #1090).

It is important that the examiner gain a thorough understanding of the business functions being outsourced by the insurer and the controls that have been put in place to mitigate risks relating to those business functions. When evaluating the insurer’s use of other TPAs, the examiner should first become familiar with the work completed during the IT review, as described in Exhibit C. The examination work completed in these areas is typically performed by an information technology examiner, and may focus on risks related to the IT function of the insurer. However, the work performed in this area should provide the financial examiner information on the relationship between the insurer and the TPA and on the overall controls in place over the outsourced function.

Once the financial examiner has performed a detail review of work performed during the IT review, the extent of additional testing to be performed for each TPA can be determined. This additional testing could include the following procedures:

1. Review the contract between the insurer and the TPA to determine that appropriate provisions have been included (ownership of data, termination of contract, right to review records, etc.). Those TPAs subject to Guideline #1090 may face specific requirements in these areas including licensure.

2. Perform a detailed review of any available Service Organization Reports, as described below, to determine that relevant controls are in place at the TPA and operating effectively (see additional guidance above). The examiner should note that although a Type II SOC 1 report may have been issued for the TPA, the controls tested may not mitigate the risks that concern the examiner.

3. If no Service Organization Report has been issued for the TPA, determine whether the insurer has taken appropriate steps to ensure that adequate controls are in place at the TPA and are operating effectively. The insurer may take various actions to determine the adequacy and effectiveness of controls in place at the service provider including performing periodic site visits, performing off-site reviews, and/or maintaining additional reporting requirements for the TPA. For insurer’s subject to Guideline #1090, there are requirements that significant TPAs be subject to a semiannual review of operations. At least one such review must be an on-site audit of the operations of the TPA.

4. If the examiner determines that the work performed to determine the adequacy and operating effectiveness of the TPA’s controls is insufficient, additional testing should be performed in accordance with the materiality of the function being outsourced and the specific risks identified. This additional testing could include requesting the insurer to perform additional testing of its TPA or having the examiner visit the TPA’s site to perform testing on the relevant controls.

SSAE 18 and Service Organization Controls Reports

(a) Overview

As discussed above, many insurance companies use non-affiliated organizations to perform such services as data processing, payroll processing, claims processing, etc. As part of the planning process for a financial statement audit or examination of an insurer that uses a third-party service organization, the auditor or examiner should consider the internal control environment at this service organization.

The most effective means for gaining an understanding of the internal control environment at the service organization is by reviewing the Service Organization Controls (SOC) report, if available. There are several types of SOC reports, each of which adhere to standards set by the American Institute of Certified Public Accountants (AICPA) as discussed below. Gaining an understanding of the internal control environment should be beneficial to examiners in understanding the servicing entity’s role and its impact on the insurer’s internal controls, whether the internal control design and operating effectiveness was considered adequate by the external auditor, and whether
the external auditors were able to rely on the service entity’s controls. These considerations should further assist the examiner in determining the extent of individual work necessary to assess the company’s significant operations that have been outsourced to service providers.

(b) Types of Service Organization Controls (SOC) Reports

**SSAE 16/SOC 1**

SSAE 16 is an attestation standard developed by the AICPA to provide guidance to enable an independent auditor to issue an opinion on an organization’s internal controls over financial reporting (ICFR). SSAE 16 supersedes SAS 70 guidance for reports on ICFR at service organizations issued on or after June 15, 2011. The report issued under the new guidance of SSAE 16 is called the Service Organization Controls report 1, or SOC 1 (often referred to as a SSAE 16 Report). SOC 1 engagements are performed in accordance with SSAE 16 and focus solely on controls at the service organization that are likely to be relevant to an audit of a client’s financial statements. SSAE 16 does not include pre-determined control objectives or control activities that organizations must achieve; rather, it is designed to provide information about the service organization’s ICFR environment to user organizations and user auditors.

**SSAE 18**

In 2017, the AICPA further updated its attestation standards for SOC reports with the issuance of SSAE 18. The new guidance is effective for reports dated on or after May 1, 2017. Importantly, while SSAE 16 only applies to SOC 1 reports, the guidance within SSAE 18 also applies to SOC 2 and SOC 3 reports.

The reports issued under SSAE 18 are substantially similar to those issued under the former SSAE 16 with an added focus on controls at a subservice organization.

**SOC for Cybersecurity**

SOC for Cybersecurity examinations are performed in accordance with the AICPA Attestation Guide “Reporting on an Entity’s Cybersecurity Risk Management Program and Controls”. These reports are similar to the Service SOC 2 reports discussed below, but differ in scope and therefore in the way that each report can be used. While a SOC 2 report is intended to be used by companies that use a company as a service organization and therefore need assurance over the controls in place to provide those services, a SOC for Cybersecurity report is intended for a broader audience and provides more general information about the entity’s cybersecurity risk management program.

**SOC 2 & SOC 3**

SOC 2 and SOC 3 engagements do not fall within scope of SSAE 16. These engagements are performed in accordance with AT 101 – *Attestation Engagements and for reports issued on or after May 1, 2017, in accordance with SSAE 18*, to address system controls based on AICPA Trust Services Principles, Criteria, and Illustrations.

Unlike SOC 1 engagements, SOC 2 engagements use predefined criteria in the Trust Services Principles, Criteria, and Illustrations. In a SOC 2 report, the service auditor would specifically address one or more of the five key system attributes comprising the Trust Services Principles, Criteria and Illustrations; Security, Availability, Processing Integrity, Confidentiality, or Privacy.

Similar to the SOC 2 report, the SOC 3 report uses the predefined criteria in the Trust Services Principles, Criteria, and Illustrations. The key difference between these two reports is that the SOC 3 report is a general-use report, typically used for branding purposes by the service organization. The SOC 3 does not provide a description of the tests performed, results of testing, or the auditor’s opinion on the description of the system.

In the context of this handbook, the SOC 2 report will generally be of greater use to examiners than the SOC 3 report, as the SOC 3 report does not provide its users with sufficient detail about the design and operation of controls.
(c) Type I vs. Type II

When a CPA performs a SOC 1 or SOC 2 audit or examination of a service organization, the SOC report that is issued is classified as either Type I or Type II.

Type I Report
A Type I report describes the organization’s controls at a specific point in time and includes the independent auditor’s report. The auditor will express an opinion on whether the organization’s description of controls presents the relevant aspects of the organization’s actual controls in operation as of a specific date, and whether the controls were suitably designed to achieve specified control objectives.

Type II Report
Similar to a Type I report, a Type II report includes the organization’s description of controls and auditor’s opinion. What differentiates the Type I report from the Type II report is that the Type II report includes detailed testing of the organization’s controls for the period specified in the report, typically one year. In addition to expressing an opinion on the same items noted in a Type I report, the auditor will also indicate whether the controls that were tested were operating with sufficient effectiveness to provide reasonable, but not absolute, assurance that the control objectives were achieved during the period specified.

(d) SOC Report Section Contents

Independent Auditor’s Report (Opinion)
This report is typically a one to two-page letter from the independent auditors to the management of the service organization. The language of the opinion generally follows explicit guidelines as determined by the AICPA, including a description of the auditor’s approach and the scope of the audit. For Type I and Type II engagements, the opinion should state whether the organization’s description of controls presents fairly, in all material respects, the relevant aspects of the organization’s controls that had been placed in operation as of a specific date (Type I) or during the period covered by the report (Type II), whether the controls were suitably designed to achieve the specific control objectives, and for Type II engagements, whether the tested controls were operating with sufficient effectiveness to provide reasonable, but not absolute, assurance that the control objectives were achieved during the period specified.

Management Assertion
Management of the service organization must provide the service auditor a written assertion that will either accompany the service auditor’s report or be included within the system description. This written assertion is much like the management representation letter previously required under SAS 70 guidance. Management must assert to the fairness of the system description, the suitability of the design of controls and, for Type II engagements, the operating effectiveness of the controls. Further, if the service organization uses subservice organization(s), management of the subservice organization(s) must also provide an assertion to accompany the auditor’s report.

System Description
Management of the service organization is required to provide a detailed description of the system in place at the organization. This description should include, among other things, the nature of services provided to user entities, how these services are performed, the service organization’s controls over the services provided, and the related control objectives. One key area to note within this section is the User Control Considerations (UCC). UCCs work hand-in-hand with internal controls. Therefore, in order for users to benefit from the SOC report, they must ensure the related UCCs are in place and functioning at the user organization. To illustrate this point, refer to the UCC example below:

| User organizations should have controls in place to restrict access to the secure web portal that is used to transmit data to the service organization to only authorized individuals. |
| Controls should include notifying the service organization when an individual’s access is no longer required or if authentication credentials have been compromised. |
Information Provided by the Service Auditor
This section is optional in a Type I report. Examples of information that might be included in this section are a more detailed description of the objectives of a service auditor’s engagement or information relating to regulatory requirements. In a Type II report, this section of the SOC report features a description of the auditor’s tests of operating effectiveness of controls and the results of those tests. The following elements should be included in the description:

- The controls tested and the objectives the controls were designed to achieve; and
- An indication of the nature, timing, extent and the results of the tests supplied in sufficient detail to enable user auditors to determine the effect of such tests on their assessment of control risk. In evaluating these factors, user auditors should also keep in mind that, for certain assumptions, the shorter the period covered by a specific test and the longer the time elapsed since the performance of the test, the less support of control risk reduction the test may provide.

Other Information Provided by the Organization
A service organization may want to present other information that is not part of the description of controls. This type of information would be included in a separate section and would not be covered by the auditor’s opinion. Examples of information that might be included in this section are responses to exceptions noted in the report and certifications achieved by the service organization (i.e., ISO Certification).

(e) Examiner Considerations in using SOC Reports

SOC 1 Report
The SOC 1 report is the most common of the three SOC reports and the intended replacement for the SAS 70. The majority of insurers using third party administrators should have access to the SOC 1 for these service organizations. The SOC 1 reports provide significant information regarding the internal control environment as it relates to financial reporting at the service organization. A SOC 1 report may be a Type I or Type II report, with the Type II being most useful for purposes of financial examinations. Examiners should obtain this report if it is applicable for the insurer under examination.

SOC 2 Report
The SOC 2 report provides reporting options beyond financial controls, covering technology-related areas of primary interest to service providers and user entities such as security, availability, processing integrity, confidentiality and privacy. A few examples of when SOC 2 would likely be beneficial include when the insurer under examination is using a service provider for:

- Cloud computing services
- Call center services
- Sales force automation

As with SOC 1, the SOC 2 report may be either a Type I or Type II report, with the Type II being more useful for financial examinations.

SOC 3 Report
The SOC 3 report is the least relevant SOC report in regards to audits and examinations. It is not expected that the SOC 3 report would be obtained during the course of an examination.

Type I SOC
Type I reports could be helpful in providing a sufficient understanding to plan the audit of the user organization. Such a report, however, is not intended to provide any evidence of the operating effectiveness of the relevant controls that would allow the user auditor to reduce the assessed level of control risk. Since no tests were performed on the controls, no reliance can be placed on a Type I report, and therefore, will not satisfy the needs of external auditors or state regulators.
Type II SOC
The Type II report is the report that should be requested and obtained by state regulators. Since testing of controls has been performed, state regulators may decide to place reliance on the report and reduce testing of internal controls. It should be noted that the state regulator remains responsible for evaluating the evidence presented by the service auditor and for determining its effect on the assessment of control risk at the service organization. The user auditor’s assessment of control risk is based on the combined evidence provided by the service auditor’s report and the user auditor’s own procedures.

User Control Considerations (UCCs)
Examiners should review the User Control Considerations (UCCs) within the SOC report carefully. In order for the controls reviewed within the SOC report to be reliable, the examiner must ensure that the UCCs noted in the SOC report are in place and operating at the user organization (the insurer).

Other Considerations
Examiners should note that, because the report may be intended to satisfy the needs of several different user auditors, a user auditor should determine whether the specific tests of controls and results in the SOC report are relevant to assertions that are significant in the user organization’s financial statements. Furthermore, examiners should consider whether exceptions identified by the service auditor will affect reliance upon those controls.

Contact with the servicing entity’s auditor may be necessary to better understand the scope and results of the auditor’s work. If necessary, the examiner may need to contact the servicing entity to perform additional work regarding specific controls and/or their effectiveness.

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.

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 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.

5. Maintenance of Workpapers

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

6. 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. 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.

H. Considerations for Insurers in Run-Off

Run-off may be either a voluntary or state mandated course of action where the insurer ceases writing new policies on a portion of business or all business written. During run-off, the insurer typically continues collecting premiums on mandatory policies for a statutorily mandated period and to policy expiration dates. The degree and timing of the reduction in premiums should be closely monitored through projections, which are often provided within a run-off plan. The run off of claims becomes the focus of attention until the last dollar of exposure is paid. The risk exposures for insurers in run-off are likely to be different than that of an insurer writing new business; therefore it may be necessary for an examiner to narrow the focus of the financial condition examination and ongoing solvency oversight of the insurer. For example, when examining a company in run-off, the examiner may be able to reduce testing performed in traditional areas, such as underwriting. The focus of the examination of a run-off insurer may include, but not be limited to, the following:

Run-off Plan
A company in run-off will typically prepare a run-off plan outlining how it will manage its resources in this stage of its operations. The specific content of the run-off plan may vary depending upon the line and nature of business in run-off and the financial condition of the insurer. If the company has prepared a run-off plan, the examiner should obtain the plan and gain an understanding of the process the company has chosen for winding down its business and the primary risks that remain. In addition, the examiner should track the company’s progress against its plan to assist in evaluating the effectiveness of the run-off. If the company has entered into run-off since the prior exam, the department analyst may have already obtained the run-off plan. Therefore, the examiner should consult with the analyst prior to requesting the run-off plan from the company.

Corporate Governance
Insurers in run-off are faced with unique challenges in maintaining effective oversight and staffing in circumstances of decreasing resources. Some areas of corporate governance that may be more critical for an insurer in run-off include employee compensation and retention, succession planning, and adequate oversight of critical functions by the Board of Directors and senior management. Evaluating the suitability of key management becomes of increased importance in an environment of high turnover and changing responsibilities. The examiner may also consider whether the company’s decreasing resources create segregation of duties issues that limit the effectiveness of the company’s internal control structure.

Capital and Liquidity Management
An objective of an insurer in run-off is to manage its assets and liabilities and maintain sufficient cash flow to ensure claim payments are met. Ideally, the insurer will reduce liabilities over time while ensuring its balance sheet maintains liquid assets to pay claims. When assessing liquidity and surplus adequacy, the examiner should evaluate the appropriateness of the insurer’s investment portfolio, including proper asset/liability matching. An insurer in
run-off would generally be expected to maintain a conservative strategy in order to preserve the ability of invested assets to meet run-off obligations. An aggressive strategy may warrant additional scrutiny by the examiner. The examiner may also evaluate whether the insurer has performed analyses to determine further cash flow needs and stress testing to assess its capital needs. In some circumstances, the examiner may consider involving an actuarial specialist to assist in evaluating the adequacy of the insurer’s capital.

Loss and Loss Adjustment Expense (LAE) Reserves
Loss reserves are the largest liability reported by an insurer and one of the most critical pieces of data in assessing an insurer that has entered run-off. Many run-off insurers are thinly capitalized. Given the materiality of this liability, a slight variance in reserves can have a significant impact on the insurer’s ability to continue as a going concern. As a result, there is increased importance placed on highly accurate reserve estimations as well as close monitoring of loss reserves. When examining an insurer in run-off, the examiner should consider focusing procedures on the company’s processes for determining loss reserves, reviewing loss reserve development trends, and involving an actuarial specialist in evaluating the overall adequacy of the reserves held.

I. Considerations for Potentially Troubled Insurance Companies

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

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

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

Communication Expectations

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

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

**Pre-Receivership Considerations**

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

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

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

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

**J. Comments and Grievance Procedures Regarding Compliance with Examination Standards**

This section covers procedures to be followed by industry and regulators relating to comments and grievances involving compliance with examination standards.

Each comment or grievance must be put in writing and presented in the following format. The matter is to be addressed to the Examination Oversight (E) Task Force.

The resolution of each submission either will be made or administered by the Task Force with ratification by the parent committee of the NAIC. Subsequent to ratification of action taken, the person making the submission will be notified.

The above procedure should suffice to receive and properly respond to any and all matters involving compliance with examination standards.
COMPLIANCE WITH EXAMINATION STANDARDS

COMMENTS AND GRIEVANCES

Date:

To: Chair, Examination Oversight (E) Task Force

From:

Nature of Comment and/or Grievance and Proposed Method for Resolution, if any. (Please submit complete particulars together with any references, etc.)
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XI. REVIEWING AND UTILIZING THE RESULTS OF AN OWN RISK AND SOVENCY ASSESSMENT

This section of the Handbook provides general guidance for use in reviewing, assessing and utilizing the results of an insurer’s confidential Own Risk and Solvency Assessment (ORSA) in conducting risk-focused examinations. Therefore, this guidance may be used in support of the risk management assessments outlined in other sections of the Handbook (e.g., Phase 1, Part Two: Understanding the Corporate Governance Structure, Exhibit M – Understanding the Corporate Governance Structure) at the discretion of Lead State examiners.

A. Background Information

The NAIC’s *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. The model gives the insurer and insurance group discretion as to whether the report is submitted by each individual insurer within the group or by the insurer group as a whole. (See the *NAIC ORSA Guidance Manual* [ORSA Guidance Manual] for further discussion.) Throughout the remainder of this chapter, the term “insurer” is used to refer to both a single insurer for those situations where the report is prepared by the legal entity, as well as an insurance group when prepared at that level. However, in some cases, the term group is used to reinforce the importance of the group-wide view.

As stated in the ORSA Guidance Manual, the ORSA has two primary goals:

1. To foster an effective level of enterprise risk management (ERM) for all insurers, through which each insurer identifies, assesses, monitors, prioritizes and reports on its material and relevant risks identified by the insurer, using techniques appropriate to the nature, scale and complexity of the insurer’s risks, in a manner adequate to support risk and capital decisions.

2. To provide a group-level perspective on risk and capital as a supplement to the existing legal entity view.

The ORSA is the company’s “own” process. For state insurance regulators, it is a tool to supplement the analyst’s ongoing reviews of company/group data and filings and document key aspects of the company’s/group’s ERM. State insurance regulators are expected to assess the ORSA and what it suggests about the state of ERM at the levels of the company/group and group-wide risks. While there are reporting requirements in the ORSA Guidance Manual, the necessary process and calculations remain the responsibility of management.

The ORSA Guidance Manual states that state insurance regulators should obtain a high-level understanding of the insurer’s ORSA framework, and it discusses how the ORSA Summary Report may assist in determining the scope, depth and minimum timing of risk-focused analysis and examination procedures.

These determinations can be documented as part of each insurer’s ongoing supervisory plan. However, the ORSA Guidance Manual also states that each insurer’s ORSA will be unique, reflecting the insurer’s business model, strategic planning, and overall approach to ERM. As state insurance regulators review ORSA Summary Reports, they should understand that the level of sophistication for each group’s ERM program will vary depending upon the size, scope and nature of business operations. Understandably, less complex organizations may not require intricate processes to possess a sound ERM program. Therefore, state insurance regulators should use caution before using the results of an ORSA review to modify...
ongoing supervisory plans, as a variety of practices may be appropriate depending upon the nature, scale and complexity of each insurer.

There is no expectation with respect to specific information or specific action that the Lead State regulator is to take as a result of reviewing the ORSA Summary Report. Rather, each situation is expected to result in a unique ongoing dialogue between the insurer and the Lead State regulator focused on the key risks of the group. For this reason, as well as others, the Lead State analyst may want to consider including the Lead State examiner or any other individual acting under the authority of the commissioner or designated by the commissioner with special skills and subject to confidentiality that may be of assistance in their initial review of the ORSA Summary Report in possible dialogue with the insurer since the same team will be part of the ongoing monitoring of the insurer and an ORSA Summary Report is expected to be at the center of the regulatory processes. A joint review such as this prior to the Lead State analyst documenting his or her summary of the ORSA report may be appropriate.

In completing a review of the ORSA Summary Report, the lead state analyst should direct the lead state examiner to those areas where such additional support is necessary to address unresolved questions or issues that may have arisen from the analyst’s review of the ORSA through on-site inquiries and interviews, observation, and testing where necessary. These items can be accumulated by the analyst on Appendix B of the template in the Financial Analysis Handbook for follow-up and communication. If there are specific reports, information and/or control processes addressed in the ORSA Summary Report that the lead state analyst feels should be subject to such additional procedures by the examination team, the lead state analyst is expected to provide direction as to its findings of specific items and/or recommended testing, and such amounts should be listed in the template by the lead state analyst. During planning for a financial examination, the lead state examiner and lead state analyst should work together to develop a plan for additional testing and follow-up where necessary. The plan should consider that the lead state examiner may need to expand work to address areas of inquiry that may not be identifiable by the lead state analyst.

In addition to this specific expectation, during each coordinated financial condition examination, the exam team, as directed by the lead state examiner and with input from the lead state analyst, will be expected to review and assess the insurer’s risk management function through the utilization of the most current ORSA Summary Report received from the insurer. The lead state will direct the examination team to take steps to verify information included in the report and test the operating effectiveness of various risk management processes on a sample basis (e.g., reviewing certain supporting documentation from Section I; testing the reasonableness of certain inputs into stress testing from Section II; and reviewing certain inputs, assumptions and outputs from internal capital models).

Examiners are reminded that ORSA information is highly sensitive, proprietary and confidential, and examiners should exercise caution to ensure that no ORSA or ORSA-related materials are inadvertently made public in any way, including in any Exam Report. Depending upon the examination schedule or cycle, the Lead State examiner may consider performing a limited-scope exam to conduct on-site examination activities related to ORSA information on a timely basis. In incorporating a review of ERM/ORSA information into financial exam activities, the Lead State examiner should seek to utilize existing resources to avoid duplication of efforts and provide exam efficiencies.

In cases where one insurer provides an ORSA Summary Report, the domestic state is responsible for verifying, assessing and utilizing the information received to facilitate and gain efficiencies in conducting on-site examinations. In cases where a group of insurers provides an ORSA Summary Report (or multiple legal entities within an insurance group provide separate ORSA Summary Reports), the Lead State is expected to coordinate the review, assessment and utilization of the information received to facilitate and gain efficiencies in conducting coordinated examinations in accordance with Section 1, Part I of the Handbook. To the extent that an insurance group is organized into subgroups for examination purposes, the review, assessment and utilization of various aspects of the insurance group’s ORSA Summary Report may require delegation of responsibilities to an Exam Facilitator. However, in all cases, examination teams should seek to avoid duplication and utilize existing work in reviewing, assessing and utilizing the ORSA Summary Report to conduct examinations of entities that are part of an insurance group. Throughout the remainder of this document, the term “Lead State” is used before the term “examiner” or “regulator” with the understanding that in most situations, the ORSA Summary Report will be prepared on a group basis, and, therefore, primarily reviewed by the Lead State. However, this does not remove the requirement for the domestic state to perform these responsibilities in the event of a single-entity ORSA Summary Report.
For additional guidance for sharing the ORSA Summary Report and/or the Lead State’s analysis of the ORSA Summary Report with other regulators and/or other third parties, refer to the ORSA Information Sharing Best Practices found on the ORSA Implementation (E) Subgroup webpage.

B. General Summary of Guidance for Each Section

This section is designed to assist the examiner through general guidance regarding how each section of the ORSA Summary Report is expected to be reviewed and assessed during a financial examination. This guidance is expected to evolve over the years, with the first couple of years focused on developing a general understanding of ORSA and ERM. Each of the sections of the ORSA Summary Report requires distinct consideration to be adequately understood and assessed. However, each of the sections can supplement the understanding and assessment of the other sections. For example, Section II provides an insurer the opportunity to demonstrate the robustness of its processes by including a detailed description of the reasonably foreseeable and relevant material risks it faces and their potential impact to the insurer. This can allow the Lead State regulator to gain a better understanding and increased appreciation for the insurer’s processes to identify and prioritize reasonably foreseeable and relevant material risks described in Section I. Alternately, the Lead State regulator may assess stresses applied to individual risks in Section II as appropriate, but may not feel stresses are appropriately aggregated to determine an adequate group capital assessment in Section III. Therefore, the review and assessment of each section requires a full understanding of each of the other sections, and the Lead State regulator should exercise caution in the allocation of review responsibilities in this area.

Further, regulators do not believe there is a standard set of stress conditions each insurer should test. The Lead State examiner should never specify the stresses to be performed, nor what should be included in the insurer’s ORSA Summary Report, as this would eliminate the “Own” aspect of the ORSA and defeat its purpose, which is to permit the Lead State regulator to better understand the risk from the perspective of the insurer. This is not to suggest that the Lead State examiner should not consider asking questions about the extent to which the insurer considers particular risks, as these questions may provide the insurer an opportunity to discuss the robustness of its processes and considerations, either in specifically identified stresses or the inclusion of similar risks within a stochastic economic capital model for a particular risk.

Possible test procedures are provided for each section of the ORSA Summary Report as procedures that could be performed to address unresolved questions or issues that may have arisen from the analyst’s review of the ORSA. They are not intended to imply that procedures are necessary in every area or that all (or any) procedures are necessary for a given area. Instead, such procedures are intended to be applied in accordance with the examination budget, based on the judgment and discretion of the Lead State analyst and examination team, and in accordance with the concept of proportionality.

In applying the concept of proportionality, state insurance regulators should recognize that ORSAs of various insurers/groups will inherently vary based on a multitude of factors, including their size, geographic/international scope, lines of business, the nature and degree to which risks are assumed and mitigated, and managerial/professional and board judgement involving ERM and risk appetite. The scope of examination procedures to be applied with respect to the ORSA should therefore consider proportionality in application in all respects. For example, in assessing implementation, state insurance regulators should consider whether the design of ERM/ORSA practices appropriately reflects the nature, scale and complexity of the insurer.

Background Information
Background information procedures are provided to assist the state insurance regulator in gaining an overall understanding of the ORSA Summary Report and assessing compliance with ORSA Guidance Manual reporting requirements; (i.e., attestation, entities in scope).

Section I
The guidance in Section I is designed to assist the Lead State examiner in performing procedures to verify and validate relevant information and assess the risk management framework of the insurer. The Lead State examiner’s assessment should utilize existing assessments of the insurer’s risk management framework performed by the Lead State financial
analyst through a review of the ORSA Summary Report, but should supplement the Lead State analyst’s assessment with additional on-site verification and testing to reach a final conclusion.

The Section I procedures are focused on the overall risk management framework of the insurer/group. The procedures are presented as considerations to be taken into account when reviewing and assessing an insurer’s implementation of each of the risk management principles highlighted in the ORSA Guidance Manual.

Section II
The guidance for use in reviewing Section II is primarily focused on assisting the Lead State examiner in gaining an understanding of management’s assessment of its reasonably foreseeable and relevant material risks. In addition, the guidance assists the Lead State examiner in understanding the potential impact of reasonably foreseeable and relevant material risks by considering the stress scenarios and stress testing presented by the insurer. Finally, information in Section II can inform or support the assessment of key principles reached during a review of Section I.

In order for the Lead State examiner to understand and utilize the information on reasonably foreseeable and relevant material risks provided in Section II, the Lead State examiner must obtain a minimum level of confidence regarding the reasonability of the information presented. Section II guidance has been developed around reviewing key risks assessed by the insurer and classifying them within the nine branded risk classifications outlined in Exhibit L of this Handbook, which are used as a common language in the risk-focused surveillance process. However, examiners should not expect or require insurers to organize or present their risks in a particular manner; (i.e., by branded risk classification). Rather, the guidance should be used in a way to allow the lead state to better understand, assess and document the information presented, as well as a way to verify or validate the summary review and assessment prepared by the financial analyst (if available).

As part of evaluating the information presented on reasonably foreseeable and relevant material risks, the Lead State examiner may document how the insurer determines the appropriateness of its stress scenarios identified and stress testing performed by the insurer. However, regulators do not believe there is a standard set of stress conditions each insurer should test. Consistent with the language in the ORSA Guidance Manual, the Lead State examiner should not specify the stresses to be performed (other than in rare situations deemed necessary by the commissioner), nor what should be included in the insurer’s ORSA Summary Report beyond the basic framework necessary to understand the work performed. Therefore, guidance has been provided to assist the Lead State examiner in considering the reasonableness of the assumptions and methodologies used in conducting stress scenarios/testing and to facilitate discussion with the insurer.

Section III
The guidance for reviewing Section III of the ORSA Summary Report is intended to assist the Lead State examiner in understanding and assessing the estimated amount of capital the insurer determines is needed to sustain its current risk profile, as well as its prospective solvency position on an ongoing basis. This determination typically utilizes internally developed capital models that estimate the distribution of potential losses and associated probabilities. Other insurers might base their determination on rating agency or regulatory capital models to determine the amount of capital needed to support a particular rating or quantify the amount of capital at risk in case of extreme shocks. All of these approaches require the insurer to establish a capital quantification methodology and select supporting assumptions. Therefore, much of the guidance in this section relates back to how the insurer determines the reasonableness of the capital quantification methodology and assumptions, as well as the process undertaken by the insurer to validate the inputs, calculations and outputs.

C. Review of Background Information
The ORSA Guidance Manual encourages discussion and disclosure of key pieces of information to assist state insurance regulators in reviewing and understanding the ORSA Summary Report. As such, the following considerations are provided to assist the Lead State examiner in reviewing and assessing the information provided in these areas.

<table>
<thead>
<tr>
<th>Consideration</th>
<th>Description</th>
<th>Possible Test Procedure(s)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Attestation</td>
<td>The report includes an attestation signed by the Chief Risk Officer (CRO), or other executive responsible for ERM, indicating that the information presented is accurate and consistent</td>
<td>• Consider the results of review/test procedures performed in Sections I – III to evaluate the accuracy of information in the ORSA Summary Report to verify this attestation.</td>
</tr>
</tbody>
</table>
SECTION 1 – GENERAL EXAMINATION GUIDANCE

<table>
<thead>
<tr>
<th>Entities in Scope</th>
<th>with ERM reporting shared with the Board of Directors (BOD), or committee thereof.</th>
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<tbody>
<tr>
<td></td>
<td>• Obtain and review BOD (or appropriate committee) minutes or packets to verify that the ORSA Summary Report (or similar ERM documentation) is subject to an appropriate level of review and oversight.</td>
</tr>
<tr>
<td></td>
<td>• Compare insurance entities covered in the ORSA report to Schedule Y, the Lead State report, and holding company filings to review which entities are accounted for in the filing for discussion with the insurer.</td>
</tr>
<tr>
<td></td>
<td>• Obtain and review information provided in Form F to get an understanding of whether non-insurance entities pose a risk to the insurance entities.</td>
</tr>
<tr>
<td></td>
<td>• If necessary, obtain and review the non-U.S. ORSA report(s) to get a full understanding of the group's risk capital.</td>
</tr>
<tr>
<td></td>
<td>o Review the home jurisdiction's ORSA requirements and compare against the ORSA Guidance Manual to understand differences.</td>
</tr>
<tr>
<td>Accounting Basis</td>
<td>The scope of the report is clearly explained and identifies all insurers covered. The scope of a group report also indicates whether material non-insurance operations have been covered.</td>
</tr>
<tr>
<td></td>
<td>• Compare valuation date and accounting basis utilized across various sections of the report to ensure consistency.</td>
</tr>
<tr>
<td></td>
<td>• If multiple accounting bases are used, gain an understanding of which basis is used to manage capital.</td>
</tr>
<tr>
<td>Key Business Goals</td>
<td>The report provides an overview of the insurer’s/group’s key business goals in order to demonstrate alignment with the relevant and material risks presented within the report.</td>
</tr>
<tr>
<td></td>
<td>• Compare the key business goals summarized in the report against other insurer filings and documents (e.g., Management’s Discussion and Analysis (MD&amp;A), Holding Company Filings, submitted business plans, etc.), other regulatory documents—i.e., insurer profile summary (IPS)/group profile summary (GPS)—and the state insurance regulator's understanding of the insurer.</td>
</tr>
<tr>
<td></td>
<td>o If inconsistencies are noted, discuss with the insurer to determine if any key risks are excluded from assessment within the ORSA.</td>
</tr>
<tr>
<td>Changes from Prior Filing(s)</td>
<td>The report clearly discusses significant changes from the prior year filing(s) to highlight areas of focus in the current year review, including changes to the ERM framework, risks assessed, stress scenarios, overall capital position, modeling assumptions, etc.</td>
</tr>
<tr>
<td></td>
<td>• Focus test procedures in Section I, II and III on significant changes from prior filings.</td>
</tr>
<tr>
<td></td>
<td>• Verify appropriate governance over changes by requesting supporting documentation and approvals for a sample of changes made.</td>
</tr>
<tr>
<td></td>
<td>• After completing a review of other sections of the ORSA, consider whether all significant changes from the prior year filing were appropriately summarized and disclosed.</td>
</tr>
</tbody>
</table>

D. Review of Section I - Description of the Insurer’s Risk Management Framework

The ORSA Guidance Manual requires the insurer to discuss five key principles of an effective risk management framework in Section I of the ORSA Summary Report. Therefore, the Lead State examiner is required to review and assess the insurer’s risk management framework by considering and evaluating each of the key principles. Upon receipt of the ORSA Summary Report, the Lead State financial analyst should perform an initial, high-level assessment of each of the key principles. During an on-site examination, the Lead State examiner is expected to supplement this initial assessment with additional procedures to verify the reported information and test the operating effectiveness of the insurer’s risk management processes and practices. Upon conclusion of these procedures, the Lead State examiner should reach his or her own assessment regarding each of the five principles. This should be utilized to adjust the scope of the risk-focused examination and communicated back to the Lead State financial analyst for ongoing monitoring and adjustment of the supervisory plan.

Guidance is provided to assist the Lead State examiner in assessing the effectiveness of the insurer’s key risk management principles.
Key Principles
1. Risk Culture and Governance
2. Risk Identification and Prioritization
3. Risk Appetite, Tolerances and Limits
4. Risk Management and Controls
5. Risk Reporting and Communication

Considerations When Reviewing and Testing Key Principles
When reviewing processes described in the ORSA Summary Report, the Lead State examiner should consider the extent to which the above principles are integrated into the insurer. To do so, the Lead State examiner may need to review processes and practices beyond those documented within the ORSA Summary Report. In addition, the Lead State examiner may need to review and consider changes made to risk management processes since the filing of the last ORSA Summary Report.

In reviewing these key principles, examples of various considerations and possible test procedures for each key principle are provided. However, these considerations and procedures only address certain elements associated with the key principles, and practices of individual insurers may vary significantly. Therefore, the Lead State examiner should exercise professional judgment in determining the appropriate considerations and procedures to be performed when assessing each of the key risk management principles.

Several of these procedures may be performed in conjunction with other risk-focused examination processes, and Lead State examiners should attempt to gain efficiencies by coordinating testing and review efforts wherever possible. Lead State examiners should use professional judgment in selecting or tailoring procedures to assist in the assessment of each of the five risk management principles for the insurer. In addition, the Lead State examiner should incorporate any specific verification or testing recommendations made by the Lead State financial analyst into the planned examination procedures for Section I and consider the extent to which additional procedures should be utilized to test the changes that have been made to the insurer’s ERM framework since the last on-site examination.

1. **Risk Culture and Governance**
   It is important to note that some insurers view risk culture and governance as the cornerstone to managing risk. The ORSA Guidance Manual defines this item to include a structure that clearly defines and articulates roles, responsibilities and accountabilities, as well as a risk culture that supports accountability in risk-based decision making. Therefore, the objective is to have a structure in place within the insurer that manages reasonably foreseeable and relevant material risk in a way that is continuously improved. Key considerations and possible test procedures for use in reviewing and assessing risk culture and governance might include, but are not limited to:

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| Roles & Responsibilities       | Roles and responsibilities of key stakeholders in ERM are clearly defined and documented, including members of the BOD (or committee thereof), officers and senior executives, risk owners, etc. | • Review documentation to determine whether key stakeholders are identified and roles are clearly defined within the ERM framework.  
• Consider the results of review/test procedures performed across Sections I – III to determine whether roles are effectively implemented. |
| Board or Committee Involvement | The BOD, or appropriate committee thereof, demonstrates active involvement in the oversight of ERM activities through receiving regular updates from management on ERM monitoring, reporting and recommendations. | • Obtain and review management, BOD or committee minutes/packets for the director group responsible for ERM oversight and evaluate the level of oversight provided.  
• Interview BOD member(s) with responsibilities for risk management oversight to determine the level of knowledge and involvement of directors in risk oversight activities. |
| Strategic Decisions            | Directors, officers, and other members of senior management utilize information generated through ERM processes in making strategic decisions. | • Interview management or BOD member(s) to determine how risk management processes and results are utilized in strategic decision making.  
• Evaluate the consistency between the insurer's business strategy and its risk management processes. |
### Staff Availability & Education

The insurer/group maintains suitable staffing (e.g., sufficient number, educational background, experience) to support its ERM framework and deliver on its risk strategy.

- Evaluate whether the insurer utilizes ERM to identify strategic opportunities, as opposed to focusing only on limiting exposures.
- Obtain and review information on the staffing and activity of key ERM functions (e.g., ERM group, Internal Audit, etc.) to evaluate their level of activity and involvement.
- Select a sample of key individuals to review job descriptions and biographical information for appropriateness and suitability.
- Interview a sample of key individuals to assess their suitability and verify their involvement in the operation of the ERM framework.
- Obtain and review evidence of formalized risk training programs for staff and consider whether the training matches the risk profile of the insurer/group.

### Leadership

The CRO (or equivalent position) possesses an appropriate level of knowledge and experience related to ERM and receives an appropriate level of authority to effectively fulfill responsibilities.

- Obtain and review information necessary—i.e., biographical affidavit or equivalent—to evaluate the suitability of the CRO (or equivalent position).
- Obtain and review information necessary to evaluate the authority and resources provided to the CRO to fulfill responsibilities.
- Review BOD/committee minutes to verify CRO access and reporting to the BOD/committee on a regular basis, and assess the CRO’s response to BOD recommendations.

### Compensation

The insurer/group demonstrates that incentives, compensation, and performance management criteria have been appropriately aligned with ERM processes and do not encourage excessive risk taking given the capital position of the insurer/group.

- Obtain and review information on the insurer’s compensation plans to determine that risk management decision-making is not undermined by compensation structure.
- Obtain and review job descriptions or performance review criteria for select management positions to determine whether risk management elements are incorporated.
- Interview a member(s) of the BOD (or appropriate committee thereof) to discuss oversight of compensation, and understand if there are concerns about excessive risk taking.

### Integration

The insurer/group integrates and coordinates ERM processes across functional areas of the insurer including human resources (HR), information technology (IT), internal audit, compliance, business units, etc.

- Interview selected executives from different functional areas to get a feel for the “tone at the top” of the insurer and the level of consistency in applying risk management processes across departments.

### Assessment

The insurer’s ERM framework is subject to regular review and assessment, with updates made to the framework as deemed necessary.

- Gain an understanding of the insurer's process to review and update its ERM framework to ensure involvement of appropriate stakeholders.
- Perform procedures to verify that the insurer is reviewing and updating its framework on a regular basis.

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2. **Risk Identification and Prioritization**

The ORSA Guidance Manual defines this as key to the insurer, and responsibility for this activity should be clear. The risk management function is responsible for ensuring the processes are appropriate and functioning properly, **and that key risks of the insurer are identified, prioritized and clearly presented**. Therefore, an approach for risk identification and prioritization may be to have a process in place that identifies risk and prioritizes such risks in a way that potential reasonably foreseeable and relevant material risks are addressed in the framework. Key considerations and possible test procedures for use in reviewing and assessing risk identification and prioritization might include, but are not limited to:
### Resources

The insurer/group utilizes appropriate resources and tools (e.g., questionnaires, external risk listings, brainstorming meetings, regular calls, etc.) to assist in the risk identification process that are appropriate for its nature, size and structure.

- Obtain and review information and tools associated with the risk identification and prioritization process for appropriateness.
- Determine whether appropriate external sources have been used to assist in risk identification (e.g., rating agency information, emerging risk listings, competitor 10K filings, etc.) where applicable.
- Obtain and review lists of key risks (or risk register) at different dates to identify which risks have been added/removed to understand and assess the process.

### Stakeholder Involvement

All key stakeholders—i.e., directors, officers, senior management, business unit leaders, risk owners, etc.—are involved in risk identification and prioritization at an appropriate level.

- Interview select process owners/business unit leaders to verify their role in risk identification and prioritization.
- Interview risk management staff to understand and evaluate how risks are identified and aggregated across the insurer.

### Prioritization Factors

Appropriate factors and considerations are utilized to assess and prioritize risks (e.g., likelihood of occurrence, magnitude of impact, controllability, speed of onset, etc.).

- Assess the insurer’s process and scale by which it prioritizes the key risks identified.
- Review the approach for, and results of, the insurer’s likelihood, severity and speed of onset risk assessments, if applicable.

### Process Output

Risk registers, key risk listings, and risk ratings are maintained, reviewed and updated on a regular basis.

- Obtain and review a current copy of the insurer’s risk register.
- Verify that the insurer’s risk register is updated/reviewed on a regular basis by requesting copies at various dates.

### Emerging Risks

The insurer has developed and maintained a formalized process for the identification and tracking of emerging risks.

- Obtain and review tools and reports utilized to identify and evaluate emerging risks to determine whether appropriate stakeholders and resources are utilized in this process.

### Risk Appetite, Tolerances and Limits

The ORSA Guidance Manual states that a formal risk appetite statement, and associated risk tolerances and limits, are foundational elements of a risk management framework for an insurer. While risk appetites, tolerances and limits can be defined and used in different ways across different insurers, this guidance is provided to assist the state insurance regulator in understanding and evaluating the insurer’s practices in this area. Risk appetite can be defined as the amount of specific and aggregate risk that an insurer chooses to take during a defined time period in pursuit of its business objectives. Articulation of the risk appetite statement ensures the alignment of the risk strategy with the business strategy set by senior management and reviewed and evaluated by the board. Not included in the ORSA Guidance Manual, but widely considered, is that risk appetite statements should be easy to communicate, understood and closely tied to the insurer’s strategy.

After the overall risk appetite for the insurer is determined, the underlying risk tolerances and limits can be selected and applied to business units and specific key risks identified by the insurer. Risk tolerance can be defined as the aggregate risk-taking capacity of an insurer. Risk limits can be defined as thresholds used to monitor the actual exposure of a specific risk or activity unit of the insurer to ensure that the level of actual risk remains within the risk tolerance. The insurer may apply appropriate quantitative limits and qualitative statements to help establish boundaries and expectations for risks that are hard to measure. These boundaries may be expressed in terms of earnings, capital or other metrics, such as growth and volatility. The risk tolerances/limits provide direction outlining the insurer’s tolerance for taking on certain risks, which may be established and communicated in the form of the maximum amount of such risk the entity is willing to take. However, in many cases, these will be coupled with more specific and detailed limits or guidelines the insurer uses.

Due to the varying level of detail and specificity, different insurers incorporate into their risk appetites, tolerances and limits, Lead State regulators should consider these elements collectively to reach an overall assessment in this area and should seek to understand the insurer’s approach through follow-up discussions and dialogue. Key considerations and possible test procedures for use in reviewing and assessing risk appetite, tolerance and limits might include, but are not limited to:
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| Risk Appetite Statement | The insurer/group has developed an overall risk appetite statement consistent with its business plans and operations that is updated on a regular basis and subject to appropriate governance oversight. | • Determine whether the insurer considers legal entity regulations and capital requirements in setting its overall risk appetite (if applicable).  
• Consider whether the insurer appropriately considers both qualitative and quantitative measures of risk appetite.  
• Evaluate the appropriateness of the risk appetite statement and its consistency with the insurer's business strategy.  
• Review BOD/committee minutes or supporting materials to verify that the insurer’s risk appetite is reviewed as appropriate. |
| Risk Tolerances/Limits | Tolerances and limits are developed for key risks in accordance with the overall risk appetite statement. | • Select a sample of key risks to verify that specific tolerances and limits have been put in place.  
• Gain an understanding of the checks and balances—i.e., supervisory review—in place to ensure that tolerances and limits are in accordance with the risk appetite.  
• Review and evaluate the consistency between the insurer's risk appetite, tolerances and limits, as well as their appropriateness in light of the business strategy. |
| Risk Owners           | Key risks are assigned to risk owners with responsibility for risk tolerances and limits, including actions to address any breaches. | • Verify, as applicable, that all key risks are assigned appropriate risk owners.  
• Interview select risk owners to get an understanding of and assess their roles and responsibilities in setting/updating tolerances and limits. |

4. **Risk Management and Controls**

The ORSA Guidance Manual stresses managing risk is an ongoing ERM activity, operating at many levels within the insurer. This principle is discussed within the governance section above from the standpoint that a key aspect of managing and controlling the reasonably foreseeable and relevant material risks of the insurer is the risk governance process put in place. For many companies, the day-to-day governance starts with the relevant business units. Those units put mechanisms in place to identify, quantify and monitor risks, which are reported up to the next level based upon the risk reporting triggers and risk limits put in place. In addition, controls are also put in place on the back end, by either the ERM function or the internal audit team, which are designed to ensure compliance and a continual enhancement approach. Therefore, one approach may be to put controls in place to ensure the insurer is abiding by its limits. Key considerations and possible test procedures for use in reviewing and assessing risk management and controls might include, but are not limited to:

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| Lines of Accountability | Multiple lines of accountability—i.e., business unit or risk owners, ERM function, internal audit—are put in place to ensure that control processes are effectively implemented and maintained. | • Gain an understanding of business unit involvement in risk management and control processes to assess appropriateness.  
• Review, verify and evaluate the role of ERM staff in setting and enforcing risk management processes and controls.  
• Obtain a listing of internal audit reports to determine whether risk management processes are subject to periodic review.  
• Perform procedures to verify and evaluate the segregation of duties between business units, ERM staff, and the internal audit department in carrying out risk management responsibilities. |
| Control Processes      | Specific control activities and processes are put in place to manage, mitigate and monitor all key risks. | • Obtain minutes of internal risk management committee (or equivalent management group) meetings to review frequency and extent of oversight activities.  
• Review and evaluate how specific controls are mapped to legal entities (as appropriate if mapping is relevant to understanding of control). |
5. **Risk Reporting and Communication**

The ORSA Guidance Manual indicates risk reporting and communication provides key constituents with transparency into the risk-management processes and facilitates active, informal decisions on risk-taking and management. The transparency is generally available because of reporting that can be made available to management, the board or compliance departments, as appropriate. However, most important is how the reports are being utilized to identify and manage reasonably foreseeable and relevant material risks at either the group, business unit or other level within the insurer where decisions are made. Therefore, one approach may be to have reporting in place that allows decisions to be made throughout the insurer by appropriately authorized people, with ultimate ownership by senior management or the board, as appropriate. Key considerations and possible test procedures for use in reviewing and assessing risk reporting and communication might include, but are not limited to:

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| Training      | The importance of ERM processes and changes to the risk strategy are clearly communicated to all affected areas and business units through ongoing training. | - Obtain and review formal ERM training materials provided by the insurer to relevant employees and directors.  
- Review records of recent training sessions to verify sessions are regular and ongoing and attended by all key stakeholders involved in the design, oversight and operation of the ERM framework. |
| Key Risk Indicator Reporting | Summary reports on risk exposures—i.e., key risk indicators—and compliance with tolerances/limits are maintained and updated on a regular basis. | - Obtain a current copy of the insurer’s risk dashboard (or equivalent report) to verify that tracking for key risks is appropriate and obtain a more current view of risks since the last ORSA valuation date.  
- Verify the frequency with which risk information is accumulated and reported by selecting a sample of historical risk dashboards (or equivalent reports) to review.  
- Test the reasonableness of key risk indicator information included on the risk dashboard (or equivalent report) on a sample basis. |
| Oversight      | Summary reports are reviewed and discussed by the appropriate members of management and, when appropriate, directors on a regular basis. | - Review meeting minutes and packets to determine whether risk reporting information is evaluated by the board and used by senior management for strategy and planning purposes.  
- Gain an understanding of and evaluate the BOD’s (or committee thereof) role in reviewing and discussing the ORSA process and resulting Summary Report.  
- Select a sample of ERM information reported to the BOD for comparison against the ORSA Summary Report to validate accuracy and consistency in reporting. |
Breaches of limits and dashboard warning indicators are addressed in a timely manner through required action by management and, when appropriate, directors.

- Select a sample of breaches from recent dashboard reports to determine whether Senior Management and/or the BOD take an active role in addressing breaches and/or significant changes in risk exposure.
- For the sample selected, review and evaluate the timeliness with which breaches in risk limits are reported and communicated to the appropriate authority.

A feedback loop is embedded into ERM processes to ensure that results of monitoring and review discussions on key risks by senior management and the BOD are incorporated by business unit leaders and risk owners into ongoing risk-taking activities and risk management processes.

- Discuss with ERM staff how input and feedback from the BOD/committee or Senior Management review of summary reports is incorporated into risk management processes.
- Review relevant BOD/committee minutes and select a sample of decisions made on ERM to verify that they were appropriately incorporated into ongoing processes.

### E. Review of Section II - Insurer’s Assessment of Risk Exposure

Section II of the ORSA Summary Report is required to provide a high-level summary of the insurer’s quantitative and/or qualitative assessments of its exposure to reasonably foreseeable and relevant material risks. There may be a great deal of variation in how this information is displayed from one insurer to the next, but in most cases, insurers tend to organize this information around the reasonably foreseeable and relevant material risks of the insurer. The ORSA Guidance Manual does give possible examples of relevant material risk categories (credit, market, liquidity, underwriting, and operational risks).

In reviewing the information provided in this section of the ORSA, Lead State regulators may need to pay particular attention to risks and exposures that may be emerging or significantly increasing over time.

Lead State examiners may find the information regarding reasonably foreseeable and relevant material risk exposures the most beneficial aspect of the ORSA Summary Report, as this information may be useful in identifying risks and controls for use in the remaining phases of a risk-focused examination. This may be attributed to the fact that Section II provides risk information on the insurance group that may be grouped in categories similar to the NAIC’s nine branded risk classifications (see Exhibit L). However, the grouping of risk information in the report is entirely up to the insurer, and the Lead State examiner should not expect each of the nine branded risk classifications to be directly addressed within Section II.

**Stress Testing**

In addition to providing background information on reasonably foreseeable and relevant material risks the insurer is facing, Section II anticipates the risk exposures to be analyzed under both normal and stressed environments. Therefore, as part of evaluating the information presented, the Lead State examiner is expected to consider the stress scenarios identified and assessment techniques performed by the insurer to quantify the financial impact of risks. In so doing, the Lead State examiner should note the assumptions and methodologies used by the insurer in conducting stress scenarios/testing. The Lead State examiner should obtain information from the Lead State analyst to determine the extent to which the state has already been provided information on the assumptions and methodologies.

The Lead State examiner should consider the assessment techniques the insurer has utilized to evaluate the impact that reasonably foreseeable and relevant material risks could have on its ongoing operations. In reviewing the insurer’s efforts in this area, the Lead State examiner’s focus would be on considering if additional information and support for the stress testing of individual risks or groups of risks are available in order to test the effectiveness of such processes. In reviewing the insurer’s assessment techniques for its material and relevant (key) risks, the Lead State examiner should consider the following elements and possible test procedures:

*Note: Possible test procedures that could duplicate or overlap with procedures listed in Section I or Section III are marked with an asterisk.*

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<td>Risks Assessed</td>
<td>Key risks assessed are consistent with the</td>
<td>- Evaluate the effectiveness of risk presentation and classification.</td>
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<td>Consideration</td>
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| Presentation and Design of ERM Controls | insurer's risk identification and prioritization process, its business strategy, and the state insurance regulator’s understanding of exposures. | o If necessary, prepare feedback to the financial analyst related to the mapping of the insurer’s key risks to branded risk classifications.  
• Compare risks discussed in Section II to the insurer's risk register and prioritization documentation to ensure that all significant risks have been assessed.  
• Consider the completeness of the key risks identified by considering the insurer's business operations and strategy, as well as information presented in Form F, U.S. Securities and Exchange Commission (SEC) reports and other filings.  
• Compare risks identified by the insurer to those tracked by state insurance regulators on the IPS/GPS and risk-focused examinations.  
• If key risks appear missing, consider discussing/addressing with the insurer. |
| Operating Effectiveness of ERM Controls | Mitigation strategies and controls to address exposures are accurately presented and effectively designed for all key risks.                                                                                                           | • Verify that mitigation strategies and controls are clearly presented for all key risks identified in the summary report*.  
• Request and review additional information on mitigation strategies/controls that are not clearly presented in the report.  
• Determine whether relevant metrics are in place to monitor risk exposures on a regular basis by selecting and reviewing a sample of key reports for review*.  
• In conjunction with work performed in Phase 3 of a risk-focused examination, perform procedures to test the design effectiveness of mitigation strategies/controls for the insurer’s key risks. |
| Rationale for Assessment Techniques | Mitigation strategies and controls are operating effectively in addressing the insurer's key risks.                                                                                              | • Determine whether risk measurement metrics are compared against tolerances and risk limits by selecting a sample of key risks for review and testing*.  
• Select a sample of risks that have breached tolerances/limits to review and assess the steps taken by the insurer to escalate, remediate and address issues*.  
• In conjunction with work performed in Phase 3 of a risk-focused examination, perform procedures to test the operating effectiveness of mitigation strategies/controls for the insurer's key risks. |
| Effectiveness of Assessment Techniques | Assessment techniques and underlying assumptions are appropriately described and supported.                                                                                                       | • Verify that all significant risks are clearly assessed and presented in Section II of the ORSA Summary Report.  
• Review the descriptions of and rationale for assessment techniques utilized in the ORSA Summary Report for appropriateness.  
• Review the process used to select and document rationale for assumptions used in risk assessment, and select a sample of risks to verify documented support for the assumptions used.  
• Request and review additional information on assessment techniques not clearly presented in the report. |
|        | Assessment techniques and underlying assumptions appear reasonable and in accordance with insurer standards and industry best practices.                                                                                     | • Evaluate whether risks have been subjected to quantitative and qualitative analysis in accordance with their underlying characteristics.  
  o For those risks only subject to qualitative assessment, determine why they have not been quantitatively assessed (e.g., lack of data, lack of methodology) and consider its appropriateness. |
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<td>• Evaluate the reasonableness of assumptions used and scenario/stress testing used by the insurer to assess risks by comparing to historical results and industry best practices and/or consulting with a specialist.</td>
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<td>• Review scenario analysis and stress testing performed to verify that both capital adequacy and liquidity are addressed for all relevant key risks*.</td>
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<td>• Assess whether the time horizons used to measure key risks are appropriate given their nature.</td>
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<tr>
<td>Impact of Assessments</td>
<td>Results of assessments indicate that key risks have been effectively mitigated.</td>
<td>• Review the results of stress testing and scenario analysis to assess the sufficiency of the insurer’s capital/liquidity resources in the event of adverse situations*.</td>
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<td>• If concerns are identified related to scenario results, inquire regarding the insurer’s remediation plans and evaluate their adequacy.</td>
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**F. Review of Section III - Group Assessment of Risk Capital**

The focus of financial analysis in reviewing Section III will be to understand the insurer’s assessment of the risk capital of the entire group to withstand potential unexpected losses and detrimental events, as well as the prospective outlook of the insurer’s solvency position. The focus of the Lead State examiner in reviewing Section III should be on understanding the process the insurer used to determine its capital needs. To perform this review, the Lead State examiner may need to request additional detail supporting the group capital calculations that the insurer performed.

Insurance groups will use different approaches to group capital calculation, and they will use different accounting and valuation frameworks. For example, they may determine the amount of capital they need to fulfill regulatory and rating agencies’ requirements, but they also determine the amount of risk capital they need to absorb unexpected losses that are not accounted for in the reserves. While the insurer is free to select whichever approach or combination of approaches are appropriate to meet its needs, the Lead State examiner should consider whether the approach selected is consistent with the nature, size and extent of risks that the group faces. The Lead State examiner, in conjunction with the Lead State analyst, may need to request that management discuss their overall approach to capital management and the reasons and details of the approach so that they can be considered in evaluating the estimation of group risk capital (GRC).

The ORSA Summary Report should summarize the insurer’s process for model validation to support the quantification methodology and assumptions chosen to determine the risk capital. The Lead State examiner should evaluate the work that the insurer performed to validate the reasonableness of the quantification methodology and assumptions used. If the ORSA Summary Report does not provide a summary of the model validation process, the Lead State examiner should request copy of the validation report prepared by the insurer.

Many insurers use internally developed capital models to quantify the risk capital. In these cases, the ORSA Summary Report should summarize the insurer’s process for model validation to support the quantification methodology and assumptions chosen to determine risk capital. The Lead State examiner should evaluate the work that the insurer performed to validate the reasonableness of the quantification methodology and assumptions used. If the ORSA Summary Report does not provide a summary of the model validation process, the Lead State examiner should request copy of the validation report prepared by the insurer. With regard to the determination of the risk capital under stressed conditions, because the risk profile of each insurer is unique, there is no standard set of stress conditions that each insurer should run. However, the Lead State regulator should be prepared to dialogue with management about the selected stress scenarios if there is concern with the rigor of the scenario. In discussions with management, the Lead State regulator should gain an understanding of the modeling methods used to project available and risk capital over the duration of the insurer’s business plan, as well as the potential changes to the risk profile of the insurer over this time horizon—i.e., changes to the list of key risks—based on the business plan. This dialogue may occur during either the financial analysis process and/or the financial examination process.
Internal Capital Models
The ORSA Guidance Manual states the analysis of an insurer’s group assessment of risk capital requirements and associated capital adequacy description should be accompanied by a description of the approach used in conducting the analysis. This should include model design decisions, key methodologies, assumptions and considerations used in quantifying available capital and risk capital. Examples of information to be provided in Section III describing an insurer’s processes in this area are provided in the ORSA Guidance Manual, and Lead State examiners should become familiar with these elements in order to assess an insurer’s processes in this area.

In some situations, the insurer might purchase or license economic capital modeling software tools developed by third-party vendors that can be customized and tailored to by the insurer to operate as an internal capital model. Regardless of whether the internal capital model is developed in-house or licensed from a third-party vendor, the Lead State examiner should gain an understanding of the work that the insurer performed to validate its own models, whether completed by internal audit, a third-party consultant or some other party. The importance of reviewing the insurer’s self-validation process is not only to gain comfort on the information provided in Section III of the report, but also due to the fact that the insurer may be making business decisions based on the results of its modeling. This is an important step because the Lead State examiner is encouraged to look to the insurer’s own process by which it assesses the accuracy and robustness of its models, as well as how it governs model changes and parameter or assumption setting, and limits Lead State examiner validation of reports to more targeted instances where conditions warrant additional analysis.

Depending upon the strength of the insurer’s internal model validation processes, Lead State examiners may need to perform some level of independent testing to review and evaluate the controls over internal model(s) utilized by the insurer for its group economic capital calculation. This is largely due to the challenges inherent in developing, implementing and maintaining an effective internal capital model. In instances where independent testing is deemed necessary, this testing may consist of procedures to evaluate the appropriateness of assumptions and methodologies used in stochastic/deterministic modeling scenarios for individual risks or in estimating the amount of diversification benefit realized. In so doing, the Lead State examiner may need to select a sample of individual risks for review and consideration and involve an actuary to assist in the evaluation. When involving an actuary, the primary focus of this review would be on evaluating the reasonableness of the inputs and outputs of the models. An actuary may be able to provide input on the reasonableness of the inputs, while the outputs may be most easily tested by performing a walkthrough in which the inputs are modified, and the Lead State examiner or actuary evaluates and discusses with the insurer the impact that the change has on the outputs. There is no one set of assumptions or methodologies that fits every insurer.

External Capital Models
Many insurers utilize the output of external models (e.g., cat models, economic scenario generators [ESGs]) as an input into their internally developed capital models. These models are typically developed by third-party vendors and made available to the insurer through either a licensing or outsourced service agreement. In other instances, the insurer may use an external capital model developed for rating agency or regulatory purposes to assist in quantifying its own capital needs.

If an insurer bases its group capital assessment on third-party vendor tools, rating agency capital calculations or regulatory capital requirements, the Lead State examiner should consider what validation efforts have been conducted to allow reliance to be placed on external models. In addition, the Lead State examiner should consider whether the insurer applies a reasonable range of stress scenarios to the outputs of these models under a wide range of different scenarios.

Prospective Solvency Assessment
The ORSA Guidance Manual requires the insurer to consider the prospective solvency of the group. Many companies will include information developed as part of their strategic planning, including pro forma financial information displaying possible outcomes as well as projected capital adequacy in those future periods based on the insurer’s defined capital adequacy standard. However, the Lead State examiner should review the information provided to understand the impact such an exercise has on the ongoing business plans of the group. For example, to the extent such an exercise suggests that at the insurer’s particular capital adequacy under expected outcomes, the group capital position will weaken, or recent trends may result in certain internal limits being breached, the Lead State examiner should understand what actions the insurer/group expects to take as a result of such an assessment (e.g., reduce certain risk exposure, raise additional capital, etc.). In addition, the Lead State examiner should consider how any planned changes in risk exposure or strategy may affect
both the insurer’s short- and long-term solvency positions. Finally, the Lead State examiner should consider whether the assumptions and methodologies used in preparing the prospective solvency assessment are consistent with the insurer’s business strategy and should assess whether these assumptions and methodology are reasonable. However, there is no one set of assumptions or methodologies that fit every insurer. Regulators must use professional judgment to assess the reasonability and plausibility of capital model inputs and outputs.

In conducting examination procedures to verify and evaluate the insurer’s processes for calculating GRC and a prospective solvency assessment, the Lead State examiner should consider the following elements and possible test procedures:

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| Capital Metric(s) Used  | The capital metric(s) utilized to assess the group’s overall capital target are clearly presented and described. | • Review and validate information presented on capital measurement tools for completeness and accuracy.  
• Gain an understanding of and evaluate the scope and purpose of each of the capital models used by the group (internal and external). |
|                         | The capital metric(s) selected address all key risks of the group.             | • Gain an understanding of the risks assessed through the capital metric(s) used and determine whether all key risks of the group are included in the quantification of risk capital.  
• For external capital metrics, evaluate the appropriateness of their use considering the risk profile of the insurer/group.  
  o If necessary, involve a specialist in this evaluation. |
|                         | Individual risk components are subject to reasonable/appropriate modeling scenarios. | • Gain an understanding and evaluate the use of stochastic/deterministic scenarios in modeling the group’s exposure to key risks.  
• If necessary, involve a specialist in evaluating the appropriateness of scenarios, assumptions and methodologies used to calculate and allocate capital to individual risk components.  
• Gain an understanding of and evaluate the insurer’s/group’s processes for addressing key risks not directly quantified in its capital metrics into the risk capital process. |
|                         | Model results are calibrated to an appropriate security standard.               | • Gain an understanding of the risk capital metric (e.g., Value at Risk, Tail Value at Risk) and security standard used in the capital model and evaluate their appropriateness considering the insurer’s risk profile and exposure to tail risk. |
| Group Risk Capital (GRC)| Group risk capital is clearly presented and described on both an aggregate and per risk basis. | • Verify that the GRC presented in the ORSA Summary Report appropriately reconciles to modeled results and investigate any significant differences.  
• Identify and review significant changes in GRC (individual components and in aggregate) from the prior filing. |
| Impact of Diversification Benefit | Diversification benefit is calculated based on correlations in key risk components that are reasonable/appropriate. | • Obtain and review information on the risk aggregation process used by the insurer—i.e., correlation matrices or copulas—to address risk correlations and review the process and the overall diversification benefit taken for reasonableness.  
• If necessary, involve a specialist in reviewing and testing the aggregation process and diversification benefit calculation. |
| Available Capital       | The group’s capital is of high quality and sufficient to meet its business needs. | • Provide information on and discuss the amount of capital available to absorb losses across the group, recognizing that there may be fungibility issues relating to capital trapped within various legal entities and jurisdictions for which regulatory restrictions and supervisory oversight constrain the extent and timing of capital movement across the group.  
• Describe management’s strategy to obtain/deploy additional capital across the group should the need arise. Determine if there is any double counting of capital through the stacking of legal entities. |
| Excess Capital | • Assess the quality of group capital by determining whether it includes items such as double counting/stacking of capital and/or excessive amounts of goodwill, intangible assets, or deferred tax assets, etc. |
| Impact of Stresses on GRC | • Compare methods utilized and overall results to those from prior periods to assess consistency and identify/evaluate significant changes. • If concerns are identified over the level of excess capital available, perform procedures to determine whether sufficient additional sources of capital are available to the group and whether there are plans to access these additional sources of capital. • Review the results of stress testing and scenario analysis to assess the sufficiency of the insurer’s capital/liquidity resources in the event of adverse situations. |
| Governance and Validation | • Assess how the insurer has determined the number of scenarios to run under a stochastic modeling approach (if utilized). • Assess whether the insurer has applied reasonable unfavorable stress scenarios in determining an appropriate level of risk capital and liquidity through use of a deterministic modeling approach, particularly if relying primarily on external capital metrics. ○ Evaluate whether rating downgrades or regulatory intervention could affect the insurer’s ability to achieve its business strategy under certain scenarios. |
| Prospective Solvency Assessment | • Obtain and review the model governance policy to understand and evaluate the role of the BOD and Senior Management in overseeing internal capital models. • Obtain and review the model change authority policy to understand who is authorized to make changes to the capital model. • Verify the operating effectiveness of oversight responsibilities by reviewing supporting documentation on a sample basis. • Select a sample of significant changes in the internal capital model to verify appropriate levels of change authority and supervisory review and approval. • Assess the level of oversight in place over the selection and application of the risk capital metric and security standard used in the internal capital model. • Obtain and review the data quality policy (if available) and review work performed by the insurer to validate data inputs for completeness and accuracy. • Evaluate whether the assessment covers an appropriate time horizon, considering the insurer’s business plan and strategy. • Evaluate the methodologies to project available and risk capital over the time horizon and whether these methodologies take into account future new business. • Evaluate whether the expected changes in risk profile are consistent with the business strategy and plans presented by the group and how these changes have been incorporated into the capital projections. • If concerns are identified through a review of the prospective solvency assessment, discuss with the insurer and perform additional procedures, as necessary. |
Review of Appendix C – IAIG Risk Management Assessment Considerations (if applicable)

The ORSA Summary Report is expected to be filed at the Head of the IAIG and should describe the risk management strategy and framework for the Head of the IAIG and legal entities within the IAIG. While the considerations provided throughout this section are generally applicable to all insurers/insurance groups filing and ORSA Summary Report, there are additional risk management assessment considerations that apply to groups identified as Internationally Active Insurance Groups (IAIGs). Therefore, the group-wide supervisor may need to conduct certain assessments at the head of the IAIG or level at which the group manages its aggregated risks to ensure that group-wide considerations are appropriately evaluated and verified through examination procedures, if not already addressed above.

<table>
<thead>
<tr>
<th>Topics/Considerations</th>
<th>Possible Test Procedure(s)</th>
</tr>
</thead>
</table>
| The group-wide risk management strategy and framework encompasses the levels of the Head of the IAIG and legal entities within the IAIG, promotes a sound risk culture, and covers:  
- diversity and geographical reach of activities;  
- nature and degree of risks in entities/business lines;  
- aggregation of risks across entities;  
- interconnectedness of entities; level of sophistication and functionality of IT/reporting systems at the group level;  
and  
- applicable laws and regulations |  
- Review the risk dashboard used by legal entities to report risk exposures to the group to ensure that material exposures (including legal and regulatory exposures, when applicable) are incorporated into the group exposures.  
- Review how the group manages aggregated exposures against group risk limits and appetite, including those arising from intra-group transactions.  
- In conjunction with the IT Review performed in Phase 1 of the exam, consider the ability of the IT/reporting systems to collect risk data from legal entities and aggregate at the group level. |
| The group-wide risk management strategy is approved by the IAIG Board and implemented at the group-wide level; with regular risk management reporting provided to the IAIG Board or one of its committees |  
- Review meeting minutes and packets to determine whether group-wide risk management strategy is evaluated and approved by the IAIG Board.  
- Review the frequency and content of the reporting packet submitted to the IAIG Board or one of its committees. |
| The risk management function, the actuarial function and the internal audit function are involved in the risk management of the IAIG. |  
- Obtain and review a listing of internal audit reports to determine active and independent involvement in the risk management function and take additional steps (i.e., conduct interviews, review internal audit reports, etc.), as deemed necessary to verify.  
- Obtain an understanding of and evaluate the role of the actuarial function in the risk management of the IAIG including quantification of risk exposure and capital needs by conducting interviews, reviewing of actuarial reports, etc. |
| The group-wide risk management function coordinates and promotes consistent implementation of risk management practices at the group and legal entity level, with any material differences in practices being clearly documented and explained. |  
- Review the group’s risk management policy documentation and correspondence between the group and legal entity risk management functions.  
- Review the organization chart of the group’s risk management function to identify reporting relationships between the group and legal entities.  
- Interview individuals responsible for risk management at different levels in the organization to verify application of the group’s risk management policy and identify areas of practice departing from the policy. |
| The group-wide risk management function is adequately independent from risk-taking activities. |  
- Review the organization chart of the group’s risk management function and/or conduct interviews to identify reporting relationships and ensure staff are adequately independent from risk-taking and other operational activities. |
The group-wide risk management framework is reviewed to ensure that existing and emerging risks as well as change in structure and business strategy are taken into account.

- Internal review required annually.
- Independent review required once every three years.

**IAIG’s risk management framework and ORSA adequately incorporate the following:**

- Cross-border risk exposures
- Economic capital model
- Fungibility of capital
- Stress and reverse stress testing
- Counterparty exposures
- Liquidity risk exposures and contingency funding plans
- Summary of recovery plan options

Overall Assessment of ORSA/ERM Function

After conducting procedures to verify, validate and assess the processes and information reported on the insurer’s ERM function in each section of the ORSA Summary Report, the Lead State examiner should reach an overall conclusion regarding the maturity and reliability of the function. In so doing, the Lead State examiner should consider both processes covered in the ORSA and verified during the onsite exam, as well as ERM processes that may not have been covered in the ORSA Summary Report but were identified and tested during the exam. In reaching an overall assessment, the Lead State examiner can consider the use of Handbook guidance, examiner judgment and/or the use of third-party tools, such as the Risk and Insurance Management Society’s (RIMS’s) Risk Maturity Model (RMM).

Insurers or insurance groups may utilize various frameworks in developing, implementing and reporting on their ORSA processes (e.g., COSO Integrated Framework, ISO 31000, International Association of Insurance Supervisors [IAIS] Insurance Core Principle [ICP] 16, other regulatory frameworks, etc.). Elements of the RMM have been outlined in this guidance to provide a reference for use in reviewing and assessing ERM/ORSA practices. However, as various frameworks may be utilized to support effective ERM/ORSA practices, Lead State insurance regulators should be mindful of differences in frameworks and allow flexibility in assessing ERM. The RMM provides a scale of five maturity levels upon which an insurer can be assessed. The five maturity levels can generally be defined as follows:

- **Leadership:** Risk management is embedded in strategic planning, capital allocation, and other business processes, and it is used in daily decision-making. Risk limits and early warning systems are in place to identify breaches and require corrective action from management and, where appropriate, the BOD or committee thereof.

- **Managed:** Risk management activities are coordinated across business areas, and tools and processes are actively utilized. Enterprise-wide risk identification, monitoring, measurement and reporting are in place.

- **Repeatable:** The insurer has risk management processes in place designed and operated in a timely, consistent and sustained way. The insurer takes action to address issues related to high priority risks.
SECTION 1 – GENERAL EXAMINATION GUIDANCE

- Initial: The insurer has implemented risk management processes, but the processes may not be operating consistently and effectively. Certain risks are defined and managed in silos, rather than consistently throughout the insurer.

- Ad hoc: The insurer has not developed or documented standardized risk management processes, and they are relying on the individual efforts of staff to identify, monitor and manage risks.

The design of ERM/ORSA practices should appropriately reflect the nature, scale and complexity of the insurer. In assessing the effectiveness of an insurer’s ERM program, Lead State insurance regulators should understand the level of maturity that is appropriate for the insurer based on its unique characteristics. Attainment of “Leadership” or “Managed” levels of maturity for ERM/ORSA practices may not be appropriate, nor should it be expected, for all companies. Additionally, it would be expected that the level of testing performed in an examination to verify or validate ERM maturity would be commensurate with the level of maturity assessed. For example, ERM programs assessed at a “Leadership” or “Managed” level of maturity would typically be subject to more of the suggested exam procedures highlighted above than those programs assessed at a lower level of maturity.

G. ORSA Review Documentation

As outlined above, the Lead State examiner is expected to incorporate a review of ORSA information into ongoing on-site examination activities, including workpaper documentation. This includes documenting the work completed to verify and validate information presented in the three sections of the ORSA Summary Report, as well as assessing the effectiveness and maturity of the insurer’s ERM processes. The results of such work can be documented in various areas of the examination file (e.g., Phase 1 documentation, Exhibit M, various risk matrices, etc.), as deemed appropriate.

The Lead State examiner is also expected to summarize the results and key findings/assessments in the Summary Review Memorandum (SRM) for communication to others within the department. See Exhibit AA – Summary Review Memorandum for additional guidance on relevant information to be included in the SRM on the ORSA/ERM function.

H. Utilization of ORSA Results in the Remaining Phases of the Examination

The review and assessment of the insurer’s ORSA/ERM processes during an on-site examination is meant to provide input and feedback to the Lead State financial analyst for updating the insurer’s ongoing supervisory plan and in reaching a final assessment regarding the maturity of the insurer’s ERM framework. A maturity assessment should consider the results of work performed to verify, validate and assess ERM/ORSA processes as described in the previous sections above. In addition, a maturity assessment should consider the size and complexity of the insurer/group, as well as the concept of proportionality in reaching the overall assessment.

The knowledge that the Lead State examiner gains in performing this review and assessment should be utilized to gain efficiencies, if appropriate, in the seven-phase risk-focused examination process. The extent to which the Lead State examination team utilizes information from the insurer’s ORSA/ERM processes to create efficiencies should depend upon the overall assessment of the insurer’s ERM framework as follows:

<table>
<thead>
<tr>
<th>Maturity Level</th>
<th>Resulting Examination Impact</th>
</tr>
</thead>
<tbody>
<tr>
<td>Leadership</td>
<td>The Lead State examination team may place a high degree of reliance on the insurer’s general ERM framework and related controls and may utilize ORSA conclusions to substantially reduce and focus the scope of remaining examination activities. For example, in examining insurers with ERM functions at a “Leadership” level, most (if not all) other than financial reporting, risks reviewed during the exam would be expected to come from risks assessed within Section II of the ORSA Summary Report, with corresponding mitigation strategies and controls sourced from ERM/ORSA functions.</td>
</tr>
<tr>
<td>Managed</td>
<td>The Lead State examination team may place a moderate-high degree of reliance on the insurer’s general ERM framework and related controls, while</td>
</tr>
</tbody>
</table>
considering additional testing for significant individual controls/strategies. ORSA conclusions may be utilized to reduce and focus the scope of remaining examination activities. For example, in examining insurers with ERM functions at a “Managed” level, many, other than financial reporting, risks reviewed during the exam would be expected to come from risks assessed within Section II of the ORSA Summary Report, with corresponding mitigation strategies and controls sourced from ERM/ORSA functions.

Repeatable

The Lead State examination team may place a moderate degree of reliance on the insurer’s general ERM framework and related controls, but significant individual controls/strategies should be subject to testing. ORSA information should be considered in limiting and focusing the scope of remaining examination activities. For example, in examining insurers with ERM functions at a “Repeatable” level, some, other than financial reporting, risks reviewed during the exam would be expected to come from risks assessed within Section II of the ORSA Summary Report.

Initial

The Lead State examination team may place a low degree of reliance on the insurer’s general ERM framework and related controls. Individual controls/strategies should be subject to examination testing. ORSA information should be considered in focusing the scope of remaining examination activities.

Ad hoc

The Lead State examination team should not place reliance on the insurer’s ERM framework and related controls without performing testing on individual controls/processes. ORSA information can be considered in scoping examination activities, but it should be supplemented by additional tools and resources.

While this guidance is developed with ORSA-compliant insurers in mind, the concepts may also be applied to non-ORSA companies that have implemented risk management functions. Therefore, the Lead State examination team should customize the consideration of ERM processes during each examination to meet the needs of the insurer being reviewed.

While the results of the ERM maturity assessment can be broadly utilized in customizing risk-focused examination activities, additional guidance has been prepared to provide examples of specific information obtained through the ERM/ORSA review process that may be utilized to reduce or facilitate the remaining phases of the financial examination. The Lead State examination team may be able to utilize information obtained through a review of ERM/ORSA processes to gain exam efficiencies as outlined in the following table:

<table>
<thead>
<tr>
<th>ERM/ORSA Information</th>
<th>Related Examination Process(es)</th>
<th>Explanation</th>
</tr>
</thead>
<tbody>
<tr>
<td>Section I – Description of the Insurer’s Risk Management Framework</td>
<td>Phase 1, Part Two: Understanding the Corporate Governance Structure</td>
<td>The Lead State examiner’s work to review and assess the insurer’s ERM framework (as reported in the ORSA) may be used to satisfy the requirement to review the insurer’s risk management practices as part of the Phase 1 corporate governance review. The overall assessment of ORSA/ERM framework discussed above should be completed during the planning stage of an exam.</td>
</tr>
<tr>
<td>Section I – Risk Identification &amp; Prioritization; Section II – Insurer’s Assessment of Risk Exposure</td>
<td>Phase 1, Part Five: Prospective Risk Assessment; Exhibit V – Overarching Prospective Risk Assessment; Phase 2: Identifying and Assessing Inherent Risks</td>
<td>The risks described, prioritized and quantified through the insurer’s ERM/ORSA processes should assist the Lead State examiner in identifying and assessing reasonably foreseeable and relevant material risks to be reviewed during the exam.</td>
</tr>
<tr>
<td>Section I – Risk Appetites Tolerances and Limits; Section II – Insurer’s Assessment of Risk Exposure</td>
<td>Phase 3 – Identify and Evaluate Risk Mitigation Strategies/ Controls; Exhibit V – Overarching Prospective Risk Assessment</td>
<td>Risk tolerances and limits that the insurer set may represent strategies/controls that can be relied upon to mitigate reasonably foreseeable and relevant material risks in Phase 3 of the examination process or to address overarching prospective reasonably foreseeable and relevant material risks.</td>
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<tr>
<td>Section II – Insurer’s Assessment of Risk Exposure; Section III – Group Assessment of Risk Capital</td>
<td>Phase 5 – Establish/ Conduct Detail Test Procedures</td>
<td>The results of stress testing that the insurer performed, as well as the amount of capital allocated to individual risk components, may assist the Lead State examiner in determining the ultimate impact of unmitigated residual risks on the insurer. To the extent that the insurer accepts certain residual risks and capital is allocated to the risk under a wide range of potential outcomes, the Lead State examiner may choose to document this fact in Phase 5 to avoid documenting a finding or ongoing concern in this area. However, the documentation should discuss reasonably foreseeable and relevant material risks, capital and liquidity in sufficient detail to address future solvency concerns in these areas.</td>
</tr>
<tr>
<td>Section III – Group Assessment of Risk Capital</td>
<td>Exhibit DD – Critical Risk Categories (Capital Management)</td>
<td>The overall results of the GRC assessment, as well as the prospective solvency assessment that the insurer performed, should provide evidence of whether the insurer’s capital management is adequate. This information may be used to address reasonably foreseeable and relevant material risks related to capital management required to be considered by Exhibit DD – Critical Risk Categories.</td>
</tr>
<tr>
<td>Section III – Prospective Solvency Assessment</td>
<td>Phase 6 – Update Prioritization &amp; Supervisory Plan; Phase 7 – Draft Exam Report &amp; Management Letter</td>
<td>Information provided in the insurer’s prospective solvency assessment should address the insurer’s ongoing strategy and business outlook. This information may be useful in reaching overall exam conclusions and determining steps for future monitoring efforts required to be documented in Phases 6 and 7 of the examination and communicated to financial analysis through the SRM.</td>
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SECTION 2—RISK-FOCUSED EXAMINATION PROCESS
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PHASE 1 – UNDERSTAND THE COMPANY AND IDENTIFY KEY FUNCTIONAL ACTIVITIES TO BE REVIEWED

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

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

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

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

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

Step 1: Gather Necessary Planning Information

Meet with the Assigned Analyst

Gathering information is the first step in gaining an understanding of the company. While general information may have been requested from the company during examination pre-planning through use of Exhibits B and C, the examination team should determine what other information is already available to the department before making additional information requests. To do so, the examination team should meet (in-person or via conference call) with the assigned financial analyst (and/or analyst supervisor) prior to requesting additional information for use in examination planning. An email exchange, in and of itself, is not deemed sufficient to achieve the expectation of a planning meeting with the assigned analyst.

In addition to gaining an understanding of the information already available to the department, the meeting with the analyst should focus on the company’s financial condition, prospective risks and operating results since the last examination. The analyst should be asked to discuss risks and concerns highlighted in the Insurer Profile Summary (IPS)/Group Profile Summary (GPS) and to describe the reasons for unusual trends, abnormal ratios and transactions that are not easily discernible. The analyst may also request specific matters or concerns for verification and review during the financial examination. To summarize the input received from financial analysis, the examination team should document risks identified by the analyst for further review on the examination and post significant items to Exhibit CC – Issue/Risk Tracking Template for incorporation into the examination process. When possible, the examiner should meet with the department analyst prior to scheduling “C”-Level interviews with company personnel. Meeting with the analyst can help the examiner gain a basic understanding of the company, which can then be used in planning and scoping the interview process and subsequent planning procedures.

If the company under examination has redomesticated since the prior exam, the department analyst will typically take a primary role in communicating with the prior domestic regulator in order to adequately transfer regulatory insights accumulated over years of oversight. The department analyst would then share these insights with the examiner in charge during the examiner/analyst meeting during the planning phase of the examination. This communication may include a discussion of the Insurer Profile Summary and key risks, the supervisory plan, the former regulator’s assessment of Senior Management, the Board of Directors and corporate governance, and other relevant solvency monitoring information. If after meeting with the analyst the examiner requires addition additional information or further clarification, the examiner may consider contacting the former regulator.

The avoidance of redundancy between analysis and examination processes is of critical importance for an enhanced and more efficient overall regulatory process that will benefit both regulators and industry. An efficient regulatory process fosters clarity and consistency, which results in a better understanding of how individual insurers operate across different aspects of the regulatory spectrum, including the areas of financial examination, financial analysis and other solvency-related regulation.

By utilizing information and input provided by the analysts, the examination team can request updates to existing information available to the department rather than duplicating requests for information already provided to the analyst. This process eliminates the need for examiners to redevelop the financial analysis information in the examination workpapers so that examination resources may instead be used to update the information while on-site at the insurer. Similar to the benefits of reviewing and using external or internal auditor workpapers, examiners use of detailed financial analysis workpapers in the examination files should result in examinations being more efficient and streamlined.

Gather Information Already Available to the Department

After meeting with the assigned analyst to gain an understanding of company information already available to the department, gather relevant information for use in examination planning. Exhibit A – Examination Planning Procedures Checklist provides examples of information already available to the department that may be relevant for inclusion within the examination file. Information sources may include responses to Exhibit B – Examination Planning Questionnaire, responses to the Information Technology Planning Questionnaire (see Exhibit C – Part One), as well as documentation of
ongoing monitoring completed by the insurance department analyst, state insurance departments’ and other regulators’ reports and information available through public sources.

Importantly, analysts typically perform procedures and receive documents from the company on several key areas of operation. These may include, but are not limited to, related party transactions, key reinsurance agreements and business plans/projections. Therefore, it is important that examiners and analysts have a comprehensive exchange of information to assist in reducing redundancy during an exam. Depending on the depth of review performed during the ongoing analysis process, this may include more items than those suggested or included in Exhibit B.

Examiners should note, however, that the fact that an analyst has reviewed a transaction or risk exposure does not typically eliminate the need for exam testing procedures. Instead, examiners should gain an understanding of work that has already been performed so that it can be leveraged and incorporated into the seven-phase process.

Obtain Additional Information from the Company

After meeting with the assigned analyst and gathering information already available to the department for review in examination planning, the examination team should determine what additional information is necessary to request from the company to assist in gaining an adequate understanding of the company and the risks it faces. These information requests may include requests for third party reports including SOC reports and security assessments (see Section 1, Part III, F – Outsourcing of Critical Functions for a discussion and description of SOC reports) as well as requests for information from the external auditor. An Examiner Request Log may be used to assist the examiner in requesting information from the company and its service providers, when necessary.

Hold Planning Meetings

After requesting additional information from the company to assist in examination planning, the examination team should be ready to hold meetings to discuss the details of the examination with both internal and external participants.

Internal Planning Meetings

An internal department planning meeting, or meetings, should be held to kick-off the examination and receive and review input regarding the company from other areas of the department. In preparation for this meeting, the exam team should request and receive input on the company from areas outside of solvency regulation, such as market conduct, rates and forms, legal, etc. This information received from other areas of the department should be reviewed to determine the impact on the examination plan, if any. In addition, and as necessary, the internal planning meeting(s) should include a discussion with the in-house (department) actuary to discuss the company’s historical reserving issues and extent of data validation required during the examination. This discussion should also cover the topic of actuarial resources to be utilized during the examination. If a discussion with the actuary is not deemed necessary, exam planning documentation should indicate why.

Another significant element of the internal planning meeting(s) is to discuss plans for the examination with the chief examiner or designee. Discussions with the chief examiner or designee should cover:

- Planning materiality and the preliminary examination approach
- The use of specialists (e.g., actuary, information systems, investment, appraiser, IT examiner, reinsurance expert)
- Significant events and department concerns
- Impact of industry conditions and economy on the company and examination plan
- Staffing and experience requirements
- Relationship with the internal and external auditors

Meetings with the Company and Other Regulators

After internal department meetings are completed, the examination team should meet with other affected regulators and the insurance company itself. In preparing to meet with other affected regulators, the examination team should consider the holding company group the company belongs to, if applicable. Obtaining at least a basic understanding of the holding company group and the companies that compose it will assist the examiner in determining key activities and inherent risks of the company to address during the examination. Inquiries and discussions with federal and international regulators are
especially vital when conducting examinations of insurers that are part of holding company groups (domestic or internationally) that include a company or companies that are at least in part regulated by other regulators outside of the state insurance regulatory structure. Prior to contacting these regulators, examiners should speak to other regulators in the holding company group (e.g., financial analysts, examiners from other states) to determine if communication has already taken place. This will help the examiner decide whether additional inquiries and/or a meeting are necessary to plan the examination. A few basic questions that can be asked include:

- What is your view of the current financial condition of the holding company group and the companies therein?
- Are you aware of any regulatory issues with the holding company group and/or the companies therein?
- Are there any other significant events that may affect the upcoming financial examination?

After meeting with other impacted regulators, the examination team should conduct a planning meeting with the company under examination to discuss relevant issues such as:

- The overall scope, extent and timeline of the planned examination
- Significant changes in the company’s operations, major lines of business and corporate governance
- Personnel or systems changes that would significantly affect the areas of accounting controls, procedures, systems or approval authorities
- Obtaining access to audit workpapers and scheduling a meeting with the external auditor
- Plans for scheduling interviews with key members of management and the board of directors
- Whether the company outsources critical functions to third parties
- Follow-up on requests for additional required reports and records (if necessary)
- The relationship between the company and its internal and external auditors
- Obtaining relevant internal audit reports for review and consideration
- Requesting the trial balance and other accounting records used to prepare annual financial statements

In addition to meeting with the company, the examination team should arrange a meeting with the appointed actuary to review the objectives and scope of the actuary’s work and to obtain an understanding of the methods and assumptions used in establishing the actuarially determined asset or liability.

**Other Sources of Planning Information**

The AICPA publishes audit risk alerts as nonauthoritative practice aids designed to be used as engagement planning tools. The alerts are valuable resources for the examiners to consider as they develop an overall examination program. The risk alert series includes the Insurance Companies Industry Developments and General Audit Risk Alerts. The AICPA also publishes Audit and Accounting guides that include a Property and Liability Companies guide and a Life and Health Entities guide.

**Consideration of Fraud**

A consideration of fraud in financial condition examinations should occur during the planning, testing and reporting phases of the examination. The examiner should begin this assessment during Phase 1 of the examination. To facilitate this assessment, the examiner may utilize Exhibit G – Consideration of Fraud in this Handbook (or a similar document). For additional guidance regarding the consideration of fraud, including a discussion of fraud risk factors, refer to Section 1 in this Handbook.

**Consideration of Related Parties**

A consideration of related parties should begin in Phase 1 of the examination. Related parties are defined as entities that have common interests as a result of ownership, control, affiliation or by contract. Related party transactions are subject to abuse because reporting entities may be induced to enter transactions that may not reflect economic realities or may not be fair and reasonable to the reporting entity or its policyholders. The examiner’s review of the company in Phase 1 includes gaining an understanding of the insurer’s significant related party agreements and/or transactions (e.g., pooling agreements, reinsurance contracts, intercompany management and service agreements, tax-sharing agreements, etc.). In gaining this understanding, the examiner should leverage information already obtained by the financial analyst to the extent possible. If necessary, the examiner may confirm directly with the insurer under examination to determine the
Step 2: Review of Gathered Information

The examination team should become familiar with the unique aspects of the company’s operations/products, risk management strategies/controls, and future business projections and goals. Initial steps in the planning process include reviewing the following documents to obtain an overview of the company’s general regulatory posture with the department and to identify existing areas of regulatory focus:

1. Insurer Profile Summary (IPS) – The Insurer Profile Summary will provide an executive summary of an insurer’s financial condition, risk profile, regulatory action/plans and other highlights. The profile format will provide a consistent structure that outlines the status of an insurer or group of insurers from a regulatory perspective at any given time. Each state will maintain a profile for their domestic companies.

2. Group Profile Summary (GPS) – The Group Profile Summary will provide an executive summary of the holding company system, corporate governance, ERM and other highlights incorporated from available filings and resources (e.g., financial filings, Form B, Form F, ORSA Report, Corporate Governance Annual Disclosure [CGAD], transaction filings, etc.) to outline the status of the group from a regulatory perspective. The Lead State takes responsibility for analyzing the group and maintaining the GPS, which it provides to all states with a domestic insurance entity in the group. Each domestic state is responsible for assessing the impact of the holding company on its domestic insurer.

3. General Correspondence and Other Files – Review for significant current period events that may have an impact on assessing comparative prior period work, account balances or future operations.

4. Financial Analysis Annual Financial Statement Review Package, including Examination Jumpstart Profile Reports – Meet with the financial analyst via in-person meeting or conference call to gain an understanding of work performed in the interim period. Specifically, discuss and review significant trends, key solvency ratios and scores (including IRIS ratios and FAST scores) and financial results since the date of the last examination, holding company filings, 10-K Forms, etc., with a greater focus on significant or unusual solvency results or trends. The examiner should focus on understanding what gave rise to variances in the IRIS ratios, not simply the fact that certain ratios are outside the norms. For property/casualty insurers, special attention should be given to the adequacy of loss and loss adjustment expense reserves, as well as the company’s reliance on, and the quality of, its reinsurance program. Reserves and reinsurance should be given special attention for life and other types of insurers, as well.

5. Prior Period Workpapers/Reports – A brief review should be performed to obtain a general understanding of work performed in prior periods, overall scope of work, perceived risk areas, and specific findings. The review should focus on key solvency trends and results from previous steps.

6. Financial Projections – Examiners should obtain and review the company’s documented business projections and plans, when available, to identify whether significant revisions are planned to the insurer’s operations (expansion of products, geographical representation, etc). This review will assist the examiner in identifying prospective operational and financial reporting risks so further inquiry can be completed throughout the examination process.

Significant risks or issues identified through reviewing the gathered information should be documented on Exhibit CC – Issue/Risk Tracking Template or a similar document to ensure they are carried through the remaining phases of the examination.

Step 3: Analytical and Operational Reviews

After meeting with the department’s analyst, determine if further analytical and operational review is necessary. In reaching this determination, the exam team should consider the extent of analytical review performed by the analyst,
including any relevant information on current period results provided the insurer (e.g., Management Discussion & Analysis [MD&A], company correspondence, etc.), as well as existing analytical tool results available through iSite+. It is very common and appropriate that after discussions with the department’s analyst, the exam team will determine that no further analytical review is necessary as part of the Phase 1 procedures performed.

The following guidance may be used when existing work is not available or it is not possible to rely on work performed by the financial analyst.

Performing an analytical review involves the study and comparison of relationships among data at a point in time and the trend in those relationships over periods of time. Based on an understanding of a company’s business, the examiner develops certain expectations about important financial and operating relationships. Analytical review results that support these expectations increase the level of confidence and may lead to examination efficiencies by changing the nature of tests or by reducing the extent of other procedures. Conversely, analytical review results that differ from expectations should increase overall skepticism and may require additional procedures to explain significant variations from expectations. Use of analytical review as the basis for reduction of detail examination procedures is most appropriate for activities that are determined to have low residual risk, but is not recommended for activities that have high residual risk. Additional guidance on using analytical review procedures in detail testing can be found in Phase 5.

To maximize effectiveness and efficiency, the examiner should select only those relationships that will assist in drawing meaningful conclusions. In designing analytical review procedures, the same procedure often can be used to gather evidence regarding different examination assertions. For example, a procedure used in Phase 1 to gain an understanding of the company could also be used in Phase 5 as a detail test to help determine the reasonableness of the balance. The uses of analytical review procedures are limited only by the availability of reliable information.

During initial planning, analytical review procedures are directed toward overall financial condition and profitability rather than specific accounts. These procedures are directed toward identifying such things as (1) changes in profitability trends; (2) deterioration in asset quality, liquidity, or capital adequacy; (3) changes in investment strategies; and (4) changes in the number of unauthorized reinsurance agreements. The analytical review may result in the identification of material changes in annual statement balances that would not necessarily trigger further inquiry during the examination, due to work already being performed in this area during financial analysis. If no additional concerns with the fluctuation are identified, the exam team will generally not need to investigate the issue further.

An overall analytical review of annual statement amounts and relationships is one way to update the examiner’s understanding of external and internal factors that influence the environment in which the company operates. Among other things, this review should focus attention on significant environmental pressures. An example of a review of environmental pressures would be to review changes in levels of overall interest rates and corresponding deficiency reserve considerations for interest-sensitive products. Asking management to discuss how it would or has responded to such conditions is a significant part of the review process. These analyses should assist in identifying the overall potential for examination problems and in developing the examination plan.

Other analytical steps the examiner-in-charge should perform include operational reviews. This includes evaluating the impact of pervasive factors and performing analyses, as well as holding discussions with management of the company, to gain a better understanding of the following:

a. Significant current events – Significant developments such as a new acquisition, change in key management, litigation, results of revenue agent review, or other items that may affect the company’s solvency should be identified and addressed.

b. Company conditions and issues – The examination team should adequately understand the structure and manner in which the company conducts its business to evaluate its solvency. Items such as the following should be considered:

i. Organizational structure of the entity
SECTION 2 – RISK-FOCUSED EXAMINATION PROCESS

Phase 1

ii. Key markets and product lines

iii. Major competitors

iv. Key solvency risk factors (i.e., holding significant amounts of low-grade bonds and/or troubled real estate).

c. The examination team should also evaluate industry conditions that could adversely affect the company’s prospective ability to remain solvent. Such conditions might include the following areas:

   i. Business and economic trends
   
   ii. Competitive environment
   
   iii. Regulatory changes

   d. Obtain an understanding of the company’s operations by line or book of business based on discussion with management.

**Step 4: Consideration of Information Technology Risks**

The examiner-in-charge should also become familiar with the general controls surrounding the company’s IT environment. Due to technological advancement (e.g., Internet, Intranet and e-commerce), internal control risks could be more pervasive within the IT environment than in other areas within the company. IT requires more technology insight to understand how it impacts the company’s operations. Properly assessing IT risk requires appropriate IT training, experience, and technological insight. The examiner-in-charge may want to consider consulting with a specialist who has experience in reviewing IT general controls.

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

Section 1, Part III, A – General Information Technology Review outlines the process in which an IT control environment should be reviewed. Exhibit C, Part Two (also located in this Handbook) is one tool the IT examiner can utilize while conducting the IT review. During the IT review, the IT examiner will identify risks that are relevant to the company based on their understanding of the company.

Once risks have been identified, the examiner will request control information from the company and test the appropriate controls within the IT environment. In the event an IT specialist is utilized, communication with the examiner-in-charge is critical throughout the review of IT general controls, especially when it comes to communicating findings of the review and the impact on the financial examination. As explained in Section 1, Part III, A – General Information Technology Review, the IT specialist should determine whether the IT general controls environment is effective or ineffective. It is important for the examiner to review and understand the conclusion reached by the IT specialist in order to determine the extent of testing that may be required in later phases of the exam. If necessary, the IT specialist may need to assist in completing the work for the financial examination, such as identifying and testing IT application controls.

Consideration and review of the IT environment may be customized based on the size and complexity of the insurer under examination. For additional detail, refer to Section 1, Part III – General Examination Considerations.

**Step 5: Update the Insurer Profile Summary**

Based upon the review and analysis performed up to this point, provide updates to the analyst regarding any significant initial findings for incorporation into the Insurer Profile Summary (IPS). Updates to the IPS can be suggested throughout the examination process.
B. Part 2: Understanding the Corporate Governance Structure

This section’s purpose is to assist the examiner in documenting the understanding and assessment of an insurer’s board of directors and management and its corporate governance policies and practices, including its ERM function. A favorable overall assessment of governance does not, by itself, serve to reduce the scope or extent of examination procedures; rather, specific governance controls need to be assessed for their adequacy in managing specific risks, in conjunction with other controls designed to manage the same. See Exhibit M – Understanding the Corporate Governance Structure for additional guidance in understanding the corporate governance structure of the company. When completing this assessment, the examiner should utilize the Corporate Governance Annual Disclosure (CGAD), which is required to be filed with the Department of Insurance (DOI) annually in accordance with Corporate Governance Annual Disclosure Model Act (#305) and Corporate Governance Annual Disclosure Model Regulation (#306). The CGAD provides a narrative description of the insurer’s or insurance group’s corporate governance framework and structure and may enhance examination efficiencies when leveraged. Examiners should inquire of the financial analyst to gain an understanding of and leverage the analyst’s work in assessing the company’s corporate governance.

**Holding Company Considerations**

In conducting examinations of insurers that are part of a holding company group, including Internationally Active Insurance Groups (IAIGs), the work to gain an understanding and perform an assessment of corporate governance should focus on the level at which insurance operations are directly overseen (e.g., Head of the IAIG, ultimate parent company level, insurance holding company level, legal entity level, etc.). However, in certain areas it may be necessary to also review governance activities occurring at a level above or below the primary level of focus. Many critical aspects of governance usually occur at the holding company level. Furthermore, if the insurer under examination belongs to a holding company group that has been identified as an IAIG, group level governance practices must be evaluated. Because of these factors, the exam team should seek to coordinate the review and assessment of group corporate governance in accordance with the exam coordination framework and lead state approach outlined in Section 1 of this Handbook.

Effectively structured and competent governance independently involved in a company’s risk management activities is an essential element in creating and nurturing a self-sustaining risk management culture. The use of specific corporate governance features may be different for entities that are the ultimate parent corporation from those of subsidiary companies. Components of effective corporate governance programs include:

1. Adequate competency (industry experience, knowledge, skills) of members of the board of directors;
2. Independent and adequate involvement of the board of directors;
3. Multiple, informal channels of communication between board, management and internal and external auditors to create a culture of openness;
4. A code of conduct established in cooperation between the board and management, which is reviewed for compliance and is formally approved by senior management;
5. Identification and fulfillment of sound strategic and financial objectives, giving adequate attention to risks;
6. Support from relevant business planning and proactive resource allocation;
7. Support by reliable risk-management processes across business, operations and control functions;
8. Reinforcement of corporate adherence to sound principles of conduct and segregation of authorities;
9. Independence in assessment of programs and assurance as to their reliability;
10. Objective and independent reporting of findings to the board or appropriate committees thereof;
11. Adoption of Sarbanes-Oxley provisions, regardless of whether mandated, including, but not limited to, auditor independence and whistle-blower provisions; and

12. Board oversight and approval of executive compensation and performance evaluations.

**Board of Directors**

The control environment and “tone at the top” are influenced significantly by the entity’s board of directors and audit committee. Factors include the board or audit committee’s independence from management, experience and stature of its members, extent of its involvement and scrutiny of activities, and the appropriateness of its actions. Another factor is the degree to which difficult questions are raised and pursued with management regarding plans or performance. Interaction of the board or audit committee with internal and external auditors is also a factor affecting the control environment.

Interviews of one or more members of the board of directors should be conducted to the extent necessary to identify and assess the “tone at the top.” Additionally, the examiner-in-charge and appropriate insurance department personnel may wish to meet or otherwise converse with the board or the audit committee at the commencement of an exam or any other appropriate juncture. Various factors may warrant such a meeting and include but are not limited to:

- Significant fraud uncovered at the company;
- Significant senior management changes or turnover;
- Questions the examiner-in-charge may have after reviewing the board meeting minutes; and
- Changes in the external auditor.

Specific factors do not have to exist to warrant such meetings. A meeting with the board or audit committee may take place to obtain an overview of their general functions and responsibilities. These meetings may also facilitate cooperation by management during the exam and assist in the understanding of the company and is another benefit of a top down approach. Examiners should consider the overall structure and operations of the board of directors or audit committee in determining whether a meeting would be beneficial to the examination process.

Because of its importance, an active and involved board of directors, board of trustees or comparable body – possessing an appropriate degree of management, technical and other expertise coupled with the necessary stature and mindset so that it can adequately perform the necessary governance, guidance and oversight responsibilities – is critical to effective internal control. And, because a board must be prepared to question and scrutinize management’s activities, present alternative views and have the courage to act in the face of obvious wrongdoing, it is necessary that the board contain outside directors. Although officers and employees are often highly effective and important board members that bring knowledge of the company to the table, there must be a balance. Although small and even mid-size companies may find it difficult to attract or incur the cost of having a majority of outside directors, it is important that the board contain at least a critical mass of outside directors. The number should suit the entity’s circumstances, but more than one outside director would normally be needed for a board to have the requisite balance. A board composed entirely (or principally) of officers of the company (or relatives or friends of the owner or management) cannot be viewed as capable of sufficient, independent oversight of the insurer operations.

Management is accountable to the board of directors or trustees, which provides governance, guidance, and oversight. By selecting management, the board has a major role in defining what it expects in integrity and ethical values, and can confirm its expectations through its oversight activities. Similarly, by reserving authority in certain key decisions, the board can play a role in high-level objective setting and strategic planning. In addition, with the oversight that the board provides, the board is pervasively involved in internal control.

Effective board members are objective, capable and inquisitive. They have a working knowledge of the entity’s activities and environment, and commit the time necessary to fulfill their board responsibilities. They should utilize resources as needed to investigate any issues they deem important. They should also have an open unrestricted communication channel with all entity personnel, including the internal auditors, and with the external auditors and legal counsel. The sufficiency of the diligence of the board is reflected in the substance of the minutes or supporting documentation.
Many boards of directors carry out their duties largely through committees. Their use and focus vary from one entity to another, but often include audit, compensation, finance, nominating, and employee benefits. Each committee can bring specific emphasis to certain components of internal control. For example, the audit committee has a direct role in internal control relating to financial reporting, and the nominating committee plays an important role in internal control by its consideration of qualifications of prospective board members. In fact, all board committees, through their oversight roles, are an important part of the internal control system. Where a particular committee has not been established, the related functions are carried out by the board itself.

**Audit Committee**

Over the years, attention has been given by a number of regulatory and professional bodies to establishing audit committees. Although audit committees have received increased emphasis over the years, they are not universally required, nor are their specific duties and activities prescribed. Audit committees of different entities have different responsibilities, and their levels of involvement vary.

Although some variations in responsibilities and duties are necessary and appropriate, certain characteristics and functions generally are common to all effective audit committees. Management is responsible for the reliability of the financial statements, but an effective audit committee plays an important role. The audit committee (or the board itself, where no audit committee exists) has the authority to question top management regarding how it carries out its financial reporting responsibilities, and also has authority to ensure that corrective action is taken. The audit committee, in conjunction with or in addition to a strong internal audit function, is often in the best position within an entity to identify and act in instances where top management overrides internal controls or otherwise seeks to misrepresent reported financial results. Thus, there are instances where an audit committee, or board, must carry its oversight role to the point of directly addressing serious events or conditions.

There have been longstanding audit committee requirements for public companies as set forth by SOX; however, recent modifications to the NAIC Annual Financial Reporting Model Regulation (#205)—also known as the Model Audit Rule (MAR)—have set forth audit committee requirements for non-public insurers that exceed an annual premium threshold. The requirements set forth by both SOX and MAR require an audit committee be formed, that external auditors report to that audit committee, as well requiring certain levels of independence within the Audit Committee. Examiners should ensure that insurers are complying with these regulations as part of their examination procedures.

**Other Committees**

There may be other committees of the board which oversee specific functional areas of the company, such as underwriting, strategic planning, ethics, public policy or technology. Generally, these committees are established only in certain large organizations, or in other enterprises due to particular circumstances of the entity.

The board may have a compensation committee which makes recommendations for the compensation (including salary, bonuses and stock options) of senior management of the company. If such a committee is established, it should be composed of outside directors.

**Management**

Interviews with senior management at the “C” level should be used at the beginning of the examination or at any time during the examination as necessary. “C” level management may include the CEO (Chief Executive Officer), CFO (Chief Financial Officer), COO (Chief Operating Officer), CIO (Chief Information Officer), CRO (Chief Risk Officer), Controller, Chief Actuary or other appropriate executive-level management. Examiners should consider the size of the organization in determining which individual would provide the examiner with the most beneficial information regarding the company for the stage of the examination. This interview process is a key step in the “top down” approach, beginning with senior management and then drilling down through the various levels of management to obtain a thorough understanding of the organization to assist in scoping the examination. Topics of these high-level interviews should include, but not be limited to (1) corporate strategic initiatives; (2) external/environmental factors of concern to management; (3) political/regulatory changes that might affect business; (4) competitive advantages/disadvantages; (5) management of key functional activities; and (6) how management establishes and monitors the achievement of objectives.
The examiners should consider which individuals should be interviewed and the sources of data to be evaluated to complete each planning step. The examiners should also consider the order in which the interviews are conducted, as information gleaned from certain “C”-level individuals can assist in providing additional information to tailor subsequent interviews. In order to select the individuals to interview, the examiners should obtain an organizational chart from the company and compile a list of potential interviewees. The interview list should include managers of key functional business units (depending on the company structure, lines of business or revenue centers might be more appropriate). Because all companies have different organizational structures, it is important that the interview schedule and the examination plan match the company. Examiners should form their objectives, or what they want to get out of the interview, prior to conducting the interview. In order to accomplish this, the examiner should have a basic knowledge of the job function of the person that they are interviewing. This will allow the examiner to ask relevant questions and get the most information possible in one setting, as it may be difficult to coordinate multiple contacts with a “C”-level interviewee or a member of the board of directors. The information contained in Exhibit Y – Examination Interviews provides some basic questions that an examiner may consider when conducting “C”-level interviews. Exhibit Y, however, does not provide examples for functional positions at the insurer (e.g., claims handling, sales and marketing, etc.). These functional interviews are typically best documented in a narrative format and may be done in conjunction with walkthroughs or other control documentation procedures. Exhibit CC – Issue/Risk Tracking Template or a similar document should be used in conjunction with Exhibit Y to document significant risks or concerns accumulated during the interview process.

Management’s philosophy and operating style affect the way the enterprise is managed, including the kinds of business risks accepted. An entity that has been successful taking significant risks may have a different outlook on internal control than one that has faced harsh economic or regulatory consequences as a result of venturing into dangerous territory. An informally managed company may control operations largely by face-to-face contact with key managers. A more formally managed company may rely more on written policies, performance indicators and exception reports.

Other elements of management’s philosophy and operating style include attitudes toward financial reporting, conservative or aggressive selection from available alternative accounting principles, conscientiousness and conservatism with which accounting estimates are developed, and attitudes toward information systems and accounting functions and personnel.

Management is directly responsible for all activities of an entity, including its internal control system. Naturally, management at different levels in an entity will have different internal control responsibilities. These will differ, often considerably, depending on the entity’s characteristics.

The chief executive has ultimate ownership responsibility for the internal control system. One of the most important aspects of carrying out this responsibility is to ensure the existence of a positive control environment. More than any other individual or function, the chief executive sets the “tone at the top” that affects control environment factors and other components of internal control. The influence of the CEO on an entire organization cannot be overstated. What is not always obvious is the influence a CEO has over the selection of the board of directors. A CEO with high ethical standards can go a long way in ensuring that the board reflects those values. On the other hand, a CEO who lacks integrity may not be able, or willing, to obtain board members who possess it. Effective boards and audit committees also will look closely at top management’s integrity and ethical values to determine whether the internal control system has the necessary critical underpinnings.

The chief executive’s responsibilities include seeing that all the components of internal control are in place. The CEO generally fulfills this duty by:

1. Providing leadership and direction to senior managers. Together with them, the CEO shapes the values, principles and major operating policies that form the foundation of the entity’s internal control system. For example, the CEO and key senior managers will set entity-wide objectives and broad-based policies. They take actions concerning the entity’s organizational structure, content and communication of key policies, and the type of planning and reporting systems the entity will use.

2. Meeting periodically with senior managers responsible for the major functional areas—sales, marketing, production, procurement, finance, human resources, etc.—to review their responsibilities, including how they are
controlling the business. The CEO will gain knowledge of controls in their operations, improvements required and status of efforts underway. To discharge this responsibility, it is critical that the CEO clearly define what information is needed.

Senior managers in charge of organizational units have responsibility for internal control related to their units’ objectives. They guide the development and implementation of internal control policies and procedures that address their units’ objectives and ensure that they are consistent with the entity-wide objectives. They provide direction, for example, on the unit’s organizational structure and personnel hiring and training practices, as well as budgeting and other information systems that promote control over the unit’s activities. In this sense, in a cascading responsibility, each executive is effectively a CEO for his or her sphere of responsibility.

Senior managers usually assign responsibility for the establishment of more specific internal control procedures to personnel responsible for the unit’s particular functions or departments. Accordingly, these subunit managers usually play a more hands-on role in devising and executing particular internal control procedures. Often, these managers are directly responsible for determining internal control procedures that address unit objectives, such as developing authorization procedures. They will also make recommendations on the controls, monitor their application and meet with upper level managers to report on the controls’ functioning.

Depending on the levels of management in an entity, these subunit managers, or lower level management or supervisory personnel, are directly involved in executing control policies and procedures at a detailed level. It is their responsibility to take action on exceptions and other problems as they arise. This may involve investigating data entry errors or transactions appearing on exception reports, or looking into reasons for departmental expense budget variances. Significant matters, whether pertaining to a particular transaction or an indication of larger concerns, are communicated upward in the organization.

With each manager’s respective responsibilities should come not only the requisite authority, but also accountability. Each manager is accountable to the next higher level for his or her portion of the internal control system, with the CEO ultimately accountable to the board.

Although different management levels have distinct internal control responsibilities and functions, their actions should coalesce in the entity’s internal control system.

Financial Officers

Of particular significance to monitoring functions are finance and controllership officers and their staffs, whose activities cut across, up and down the operating and other units of an enterprise. These financial executives are often involved in developing entity-wide budgets and plans. They track and analyze performance, often from operations and compliance perspectives, as well as from a financial perspective. These activities are usually part of an entity’s central or “corporate” organization, but they commonly also have “dotted line” responsibility for monitoring division, subsidiary or other unit activities. As such, the chief financial officer, chief accounting officer, controller and others in an entity’s financial function are central to the way management exercises control.

The importance of the role of the chief accounting officer in preventing and detecting fraudulent financial reporting was emphasized in the Treadway Commission report: “As a member of top management, the chief accounting officer helps set the tone of the organization’s ethical conduct; is responsible for the financial statements; generally has primary responsibility for designing, implementing and monitoring the company’s financial reporting system; and is in a unique position regarding identification of unusual situations caused by fraudulent financial reporting.” The report noted that the chief financial officer or controller may perform functions of a chief accounting officer.

When looking at the components of internal control, it is clear that the chief financial (or accounting) officer and his or her staff play critical roles. That person should be a key player when the entity’s objectives are established and strategies decided, risks are analyzed and decisions are made on how changes affecting the entity will be managed. He or she provides valuable input and direction, and is positioned to focus on monitoring and following up on the actions decided.

Enterprise Risk Management
One aspect of a company’s corporate governance is enterprise risk management (ERM). The way a company identifies, monitors, evaluates and responds to risks can be very important to the ongoing solvency of the company. ERM is, therefore, an important area for an examiner to review during the course of the examination. Exhibit M – Understanding the Corporate Governance Structure contains a section with specific areas of consideration in reviewing the risk management function. For large companies subject to the requirements of the ORSA, including IAIGs, the summary report provided by the company may be used in the evaluation of risk management. Examiners should leverage the work completed by the department analyst, as well as consider the possible test procedures outlined in the ORSA Documentation Template located in Section 1, Part XI of this Handbook in conjunction with the review of the ORSA summary report evaluating the company’s risk management framework.

C. Part 3: Assessing the Adequacy of the Audit Function

Well-planned, properly structured audit programs are essential to a strong corporate risk management process. Effective internal and external audit activities create a critical monitoring control against fraud, provide vital information to the board of directors (or audit committee) about the effectiveness of internal control systems and mitigate operating and financial reporting risk. Examiners should assess and draw conclusions about the adequacy of internal and external audit as part of the corporate risk management process. The conclusions reached from the assessment will significantly influence the scope and the extent of examination activities at the insurer. The guidance in this section pertains to both external and internal audit functions unless specifically identified.

The following guidelines direct the assessment of insurer audit activities:

1. The board of directors and senior management cannot delegate their responsibilities for establishing, maintaining, and operating effective audit activities (e.g., establishment of an annual audit plan that is reviewed by the audit committee).

2. Examiners must assess the adequacy of an insurer’s audit function.

3. Insurer audit activities will be performed by independent and competent staff that is objective in assessing and evaluating the insurer’s risks and controls.

Effective audit functions have these characteristics:

1. Provide objective, independent input on operating and financial reporting risks and internal controls, including management information systems.

2. Help maintain or improve the effectiveness of insurer risk management processes, controls and corporate governance.

3. Provide reasonable assurance about the accuracy and timeliness with which transactions are recorded and the accuracy and completeness of financial regulatory reports.

4. Provide assistance, guidance or suggestions in areas where needed.

Audit functions may comprise several individual audits that provide various types of information to the board of directors (or audit committee) about the insurer’s financial condition and effectiveness of internal control systems. The most common types of audits are financial, operational, compliance, and information technology audits.

One of the objectives of this Handbook is to develop an efficient risk-focused examination approach that provides for more timely detection of potentially troubled insurance companies by focusing examination resources on those companies, or areas within companies, that have a higher likelihood of impact to the financial solvency of the company. Examiners can enhance efficiency in the examination through appropriate communications with the company’s auditors, including but not limited to...
the nature, extent and timing of their audit procedures, any internal control testing and attestations performed (e.g., Sarbanes-Oxley, Model Audit Rule) and their views of the company and its risks. The extent to which the examiner chooses to consider the work of an auditor in performance of the examination is a matter of judgment by the examiner. In situations where the examiner determines that an effective external and/or internal audit function is in place at the insurer, the examination team may choose to identify fewer financial reporting risks for review. Conversely, when an insurer's audit function is determined to be inadequate, the examination team may elect to review more risks relating to the accuracy of financial reporting. See Exhibit E – Audit Review Procedures for additional guidance to follow when placing reliance on the work performed by auditors.

Before using an external auditor’s work, it is important to first have a basic understanding of the environment in which the external auditor operates.

External auditors may be engaged by their insurance company clients to perform, among other services, independent audits of the company in accordance with Generally Accepted Auditing Standards (GAAS) as promulgated by the American Institute of Certified Public Accountants (AICPA) or the standards of the Public Company Accounting Oversight Board (PCAOB).

The established auditing standards state, “The objective of the ordinary audit of financial statements by the independent auditor is the expression of an opinion on the fairness with which they present fairly, in all material respects, financial position, results of operations, and its cash flows in conformity with generally accepted accounting principles.” In many instances, the states require that the audit be performed on statutory financial statements in conformity with accounting practices prescribed or permitted by the domiciliary state.

Although there are several similarities between the financial reporting risk and control objectives of an external auditor and an examiner, differences may also exist. Depending on the company involved and the nature of the external auditor’s engagement, such differences may be significant, even in those situations where the external auditor is reporting pursuant to a state audit rule that may otherwise minimize such differences by requiring a separate company (as opposed to consolidated) audit report on statutory-basis (as opposed to generally accepted accounting principles, or GAAP) financial statements. Examiners and external auditors both need to assess the internal and external environment risks affecting the company (inherent risk), the ability of the company’s internal controls to identify and rectify potential material errors in account balances or transactions (control risk/control assessment), and the adequacy of their respective audit or examination procedures to identify such material errors that may exist (detection risk). How the examiner or external auditor addresses these issues during an examination or audit, and the resulting impact on their assessment of materiality and their determination of examination or audit procedures, will reflect their respective experience, training, professional judgment, and overall objectives.

Given the potential for differences that may exist between an external auditor and an examiner, there are areas where their approach, scope of work, procedures and desired documentation will converge. These areas provide opportunities for efficiencies that the examiner should utilize. For publicly held companies, in addition to standards of the PCAOB, the federal Sarbanes-Oxley Act, which requires the external auditor to attest to management’s assertion of adequate financial reporting internal controls, provides a significant opportunity for the examiner to place reliance on work completed by the company and/or external auditors. In addition, external auditors are required to adhere to the Risk Assessment Standards (SAS 104 – SAS 111) for non-public companies in order to comply with GAAS. The implementation of the Risk Assessment Standards requires auditors to gain an in-depth understanding of controls associated with financial reporting to identify potential risks based on that understanding and to determine what the insurer is doing to mitigate those identified risks. Companies are making a significant effort to perform a risk-focused, detailed analysis of their financial reporting risks and controls, and to test those controls. Internal auditors, in many cases, and external auditors will perform tests on these processes and selected controls, to allow the external auditor to issue their attestation. The requirements of Sarbanes-Oxley and the Model Audit Rule have also “raised the bar” on external auditor independence, restricting certain activities such as client internal audit outsourcing and financial system implementation project work.

To identify other areas for potential examination efficiencies relating to work performed by an external auditor, the examiner should have an adequate understanding of the overall audit scope, and for areas identified by either the examiner
or the external auditor as having a higher likelihood of material error, an understanding of the external auditor’s procedures and results thereof.

An internal audit function is also a valuable resource for the examiner to utilize. Similar to their external counterparts, internal auditors should also be independent and provide objective input regarding a company’s processes, controls and corporate governance. But internal audits may extend beyond financial reporting of the company and may include operational, compliance and information technology audits. The Institute of Internal Auditors provides a framework of standards for performing and promoting internal auditing. To be fully independent for purposes of exam reliance, internal auditors should report directly to the Audit Committee or Board of Directors instead of company management and should not assume any management responsibility.

**Notification of Examination**

Prior to the beginning of the examination, the examiner should notify the external auditor, with the assistance of company personnel, that an exam is upcoming and that the external audit work, along with any SOX or MAR work will be requested. This will allow the auditor to adjust the audit schedule, as needed, so that the external audit work will be available for the examiner as early as possible. This communication to the external auditor is recommended to occur at least six months prior to the exam as-of date, if possible. The exam team may consider asking both the external auditor and the internal auditor to focus the audit on areas of interest to the examiner that would provide efficiencies for the examination. The external auditor may also allow examiners to participate on work performed during an interim period, if appropriate.

**Decision Whether to Utilize the Work of Auditors**

Communication with the auditors will be helpful throughout the examination process. Auditors may have already identified the functional activities in an organization, assessed risks and controls, and performed detail and control testing that may be relied upon by the examiner. The examiner-in-charge should consider the work performed by both the external and internal auditors and meet with them during the planning phase of the exam. Reliance may be placed on the work performed by auditors if reasonable assurance is obtained that the audit function is independent, objective and conducts quality audits.

In order to obtain sufficient evidence to conclude that the work of the auditor may be relied upon, examiners should conduct a planning meeting with the auditors. To prepare for the initial meeting with an external auditor, the examiner should request, read and review several documents provided by the external auditor for each year since the last examination. These documents include signed audit reports—including audited financial statements, management letters, and management representation letters—and a listing of recorded and unrecorded audit adjustments, if available. At this point in the planning process, the examiner should be far enough along to have formed some tentative conclusions as to which areas of the company may represent key activities and have a higher likelihood of material error in surplus. The planning meeting with the external auditors should include key members of the engagement team, such as the engagement partner or manager, to ensure the information is sourced through those with the most knowledge and understanding of the insurer and its financial statements.

In conjunction with the planning meetings with the auditors, Exhibit E – Audit Review Procedures should be utilized by examiners to document a review of the work performed by the audit function. The review should be kept at a high level but should be sufficient enough to conclude on the scope, adequacy and quality of the audit(s) performed as well as the appropriateness of the conclusions and the consistency of the conclusions within the independent auditor’s report. Specific documentation of internal controls and auditor testing should not be reviewed in depth at this point because the examiner is only determining if the work can be relied upon. The examiner will perform a detailed review of these items in Phases 3 and 5 of the exam process if the work is deemed reliable.

Some of the key factors to consider for both external and internal audit functions when performing this review of the auditor and its workpapers are as follows:

- The independence, education, experience and general competence of the auditors involved in the audit.
• The function is adequately staffed with competent professionals.
• The reasonableness of the auditor’s assessment of risk, materiality, overall audit scope and findings.
• Workpapers are complete and organized in a logical manner including scope, audit steps, report and documentation to support findings and show evidence of supervisory review.
• Adherence to auditing standards promulgated by the American Institute of Certified Public Accountants (for external auditors) and the Institute of Internal Auditors (for internal auditors).
• Significant findings, corrective management action and status of open issues are communicated to the audit committee.

A few additional key factors that may indicate the internal audit function is independent are as follows:

• The head of internal audit reports directly to the audit committee on audit matters and may have a dotted line report into the CEO or CFO for daily matters (or similar structure).
• The audit plan is submitted to and approved by the audit committee.
• The internal audit function does not perform any operational functions within the organization.

Additionally, the examiner should specifically identify any noted issues of deliberate improper financial reporting identified by the external auditors in accordance with AU Sec. 316.

To complete the review of auditor work, the examiner should request relevant workpapers of the auditor for the years under examination and perform a review of these workpapers. In addition to reviewing current year working papers, the examiner may find reviewing the prior-year workpapers beneficial if the auditor had considered and documented specific internal controls in the prior year (see guidance in Phase 3 on reliance on control testing performed in prior periods). Obtaining the prior period workpapers is especially important in situations where current-year workpapers may be unavailable due to timing or other reasons, or if controls have been tested on a rotational basis. The examiner should give the auditor at least two weeks notice to provide the workpapers requested for review. Additional meetings with the auditor may be warranted if questions arise or additional audit documentation is necessary. Additional discussions held with the auditor and separate conclusions on the work of the external and internal auditors as to whether reliance is appropriate should be documented in the exam workpapers.

Examiners should be aware that the external auditor may perform procedures at both an interim period and at year-end. In preparing for an examination, examiners should request access to all available audit documentation, including interim workpapers or audit documentation that may not be considered complete. Should the external auditor not cooperate with the examiners in providing completed workpapers upon request, the examiner should request the assistance of company management in obtaining this information. If unsuccessful, the examiner would contact the following individuals in this suggested order, if necessary: (1) the engagement partner; (2) the designated national firm representative; (3) the Chair of the insurer’s audit committee; and (4) the State Board of Accountancy, Ethics (or Qualitative Review) Committee, or other regulatory bodies deemed appropriate. The department should determine appropriate action against the company and/or public accounting firm as permitted in accordance with the provisions of the NAIC Model Audit Rule. The provisions of this Model obligate insurers to require their external auditor to make available to the insurance department all workpapers prepared in the conduct of the auditor’s examination and any communications related to the audit between the accountant and insurer. The external auditor must agree to make available for review the audit workpapers. If such workpapers are not furnished, an insurance department whose state has adopted the NAIC model regulation may take any remedial action permitted by state law against the insurer and/or the auditor for such an infraction. Until the audit report is released and the workpapers are completed and reviewed, such workpapers are considered incomplete and are subject to change. AICPA Professional Standards indicate that when an audit has not been completed, the audit documentation is necessarily incomplete because (a) additional information may be added as a result of further tests and review by supervisory personnel and (b) any audit results and conclusions reflected in the incomplete audit documentation may change. Although the AICPA Professional Standards indicate that it is preferable that access be delayed until all auditing procedures have been completed and all internal reviews have been performed, auditors have communicated that they are generally willing to provide audit work to the examiner before the audit is finalized, as long as the work has been fully reviewed. When workpapers are furnished to the examiner prior to the completion of the audit, it is recommended that the examiner subsequently follow up with the auditor regarding any changes made to this documentation. Further, the examiner should obtain any workpapers that
may have changed. In the circumstance where access to workpapers is not provided prior to the completion of the audit, the examiner is still encouraged to meet with the auditor to discuss the external audit approach.

If access to interim external auditor workpapers is granted, the examiner should evaluate the procedures performed at the interim date. The evaluation of the external auditor’s interim work should include an understanding of the areas tested by the external auditor and all respective findings and conclusions. Alternatively, if interim external auditor workpapers are not available, the external auditor’s planned audit procedures should be considered by the examiner.

In reviewing interim audit documentation the examiner should consider the timing of the interim testing in relation to the balance sheet date. For example, detection risk (the risk that misstatements go undetected by the auditor) increases when procedures are performed before the balance sheet date. Detection risk continues to increase as the period between the interim date and balance sheet date increases. Detection risk can be reduced if the tests performed for the remaining period are designed to provide a reasonable basis for extending the interim audit conclusions to the balance-sheet date. The external auditor tests should be designed to cover the remaining period in such a way that the assurance from those tests, interim test-work, and the assessed level of control risk achieve the audit objective at the balance sheet date. Typically, auditors conduct a comparison of the account at the balance sheet date and the interim date to determine if the account fluctuated in accordance with expected activity. Analytical procedures or detail tests may be used to roll the testing forward to year-end; however, the examiner should always use professional judgment when evaluating and relying on the work performed by the external auditor.

**Utilization of the Work of Auditors**

As noted above, to the extent that the audit function is determined to be effective, the examination team may place greater reliance on the work of auditors by identifying fewer financial reporting risks for review during the examination. However, for risks that are deemed significant, the examination team may also utilize the work of auditors by obtaining, reviewing and referencing specific work performed by the auditors in the detail workpapers. For example, in Phase 3 and Phase 5 of the examination process, the examiner may incorporate the work of the auditors into the examination workpapers to provide documentation of internal controls and evidence of control and detail testing. Utilizing the work of the auditors expedites the examination by avoiding a duplication of efforts. The auditors’ work may be informative to the examiner in efficiently obtaining an understanding of the following matters:

1. The internal control structure: This Handbook requires the examiners to gain an understanding of controls as they relate to specific control objectives for an insurer. To the extent that the auditor may have also reviewed and documented internal controls or flowcharted a particular system, such work should be useful to the examiner.

2. Risk assessment: At the financial statement level or account-balance or class-of-transaction level, the auditor’s work should provide information about the effectiveness of internal control structure policies and procedures that might affect the nature or extent of testing the examiner would otherwise need to perform.

3. Compliance and detail procedures: Procedures performed by the auditor may provide direct evidence about the operating effectiveness of controls and material misstatements in specific account balances or classes of transactions. The results of these procedures can provide evidence the examiner may utilize in reducing the extent of procedures or account verification considered necessary.

Although the external auditor has provided an opinion on the presentation of the financial statements taken as a whole, the responsibility to report on the company’s solvency status in the form of a statutory examination rests solely with the examiner. Because the examiner has the ultimate responsibility to report on the examination, judgments about assessments of inherent and control risks, the materiality of misstatements, the sufficiency of tests performed, the evaluation of significant accounting estimates and other matters affecting the examiner’s report should always be considered in the examiner’s assessments. In making judgments about the magnitude of the effect of the external auditor’s work on the examiner’s procedures, the examiner should consider:

1. The materiality of financial statement amounts (including misstatements encountered by the external auditor that fall below the materiality level for the audit but which may be material to the examiner).
2. The risk (inherent and control risk) of material misstatement related to these financial statement amounts.

3. The degree of subjectivity involved in the evaluation of the audit evidence gathered.

As the materiality of the financial statement amount and the risk of material misstatement or degree of subjectivity increases, the need for the examiner to perform tests may increase. Similarly, as those factors decrease, the need for the examiner to perform tests may decrease.

Although examiners are encouraged to utilize work performed by auditors for financial statement areas that could directly impact the financial solvency of the company, consideration of the auditor’s work may not reduce examination risk to an acceptable level to eliminate the necessity of performing tests of those areas directly by the examiner. Valuation of assets and liabilities involving significant accounting estimates, related party transactions, and contingencies and uncertainties are examples of areas that might have a high risk of material misstatement or involve a high degree of subjectivity in the evaluation of audit evidence. Examiners should consider the auditor’s scope of work performed to determine whether, and to what extent, they can rely on the work performed by the auditor.

For financial statement areas where the risk of material misstatement or the degree of subjectivity involved in the evaluation of the audit evidence is low, the examiner may enhance examination efficiencies by utilizing the work completed by the auditor without completing additional testwork.

The examiner must exercise professional judgment in utilizing the work of the auditor and in developing examination procedures. Retesting the auditor’s work depends on the circumstances and is a matter of professional judgment but should be considered in relation with the amount of reliance placed on the work of the auditor.

Utilization of Company-performed Testing

In addition to using the work of auditors, circumstances may present the opportunity to utilize work performed by non-independent employees of an insurer during an examination. During the planning process, the examiner may identify work performed by risk managers, quality-assurance staff or other employees that would be applicable to the examination and that was used for: 1) complying with the federal Sarbanes-Oxley Act, the Model Audit Rule, COBIT and/or the insurer’s enterprise risk-management framework; or 2) general internal control purposes. When this work is utilized, the examiner should recognize that the work is not performed by an independent third party and, as such, requires a higher level of professional skepticism during review. The examiner must exercise judgment to determine the amount of reliance placed on work performed by these individuals and, as such, the examiner may need to perform a more detailed review and/or retesting of the work before placing reliance on it. When making this determination, considerations may include the qualifications of the personnel performing the work, any potential bias by the personnel performing the work and the overall risk attributed to the area under review. The initial determination of the examiner’s ability to place reliance on this type of work for the company being examined should be documented in the planning memo, and specific conclusions about reliance and utilization of individual tests should be documented on the related workpapers.

D. Part 4: Identifying Key Functional Activities

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

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

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

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

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

By the end of Phase 1 of the examination, the examination team should have completed a high-level review of the insurer to identify any solvency concerns that commenced or extended after the examination date, or that are anticipated to commence or extend beyond the examination completion date. Such concerns may be identified through various aspects of the planning process, such as C-level interviews, review of Form F – Enterprise Risk Report, input from the analyst, review of the most recent Form 10-K, etc. If the examiner identifies a prospective risk that relates to one specific key activity of the company, this prospective risk should be documented in the corresponding risk matrix (or similar documentation) for that key activity and should be treated the same as all other identified risks. As such, examples of risks that an examiner may want to consider in assessing prospective solvency concerns related to common key activities have been included within the examination repositories. However, if the examiner identifies an overarching prospective risk (a prospective risk that does not relate to a specific key activity identified, or relates to more than one key activity identified), the examiner should utilize Exhibit V – Overarching Prospective Risk Assessment to document the process to consider these prospective risks.

By the end of Phase 1, the examiner should have a preliminary listing of overarching prospective risks included on Exhibit V. Prospective risks may continue to be identified beyond Phase 1. Any significant overarching prospective risks identified during later phases of the exam should continue to be documented and investigated on Exhibit V, regardless of the phase in which the risk was identified. For additional guidance on identifying and investigating overarching prospective risks during the examination, see the instructions on Exhibit V – Overarching Prospective Risk Assessment.

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

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

**Annual Statement Blank Line Items**

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

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

**Relevant Statements of Statutory Accounting Principles (SSAPs)**

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

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

† Items with this symbol may warrant additional procedures or consideration at the Head of the Internationally Active Insurance Group (IAIG) or level at which the group manages its aggregated risks. Refer to Section 1, Part I for additional guidance for examinations of IAIGs. [NAIC]
<table>
<thead>
<tr>
<th>Identified Risk</th>
<th>Branded Risk</th>
<th>Exam Asrt.</th>
<th>Critical Risk</th>
<th>Possible Controls</th>
<th>Possible Test of Controls</th>
<th>Possible Detail Tests</th>
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<td><strong>Other Than Financial Reporting Risks</strong></td>
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<tr>
<td>The insurer is not monitoring its capital and surplus needs, including how</td>
<td>LQ</td>
<td>Other</td>
<td>CMT</td>
<td>Management performs capital modeling calculations, including assessing capital and</td>
<td>Obtain evidence of the capital modeling calculations performed by management, including self-</td>
<td>Consider utilizing an actuarial specialist to assist with detail test procedures.</td>
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<td>changes may impact RBC and financial strength ratings from rating agencies.</td>
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<td>liquidity needs in normal and stressed environments, to understand the insurer’s</td>
<td>validation efforts.</td>
<td>Consider applying a wide range of scenarios, including severely stressed scenarios,</td>
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<td>current and prospective capital needs.</td>
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<td>to verify the insurer’s available capital is adequate to meet its current and</td>
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<td>The board of directors (or committee thereof) reviews and approves the capital</td>
<td>Review the board of directors’ (or committee thereof) meeting minutes for evidence of the</td>
<td>Consider the impact of different scenarios on RBC and/or rating agency assessments.</td>
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<td>modeling results performed by management on an annual basis.</td>
<td>board’s approval of the capital modeling results.</td>
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<td>Management prepares financial projections that include investment, underwriting</td>
<td>Obtain evidence of financial projections and planning by management.</td>
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<td>and expenses, and their projected impact on surplus.</td>
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<td>Financial projections are reviewed by the board of directors.</td>
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<td>The insurer does not have access to</td>
<td>ST</td>
<td>Other</td>
<td>CMT</td>
<td>Management performs ongoing analysis of various</td>
<td>Review documentation describing the insurer’s</td>
<td>Perform a review of management’s available</td>
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<td><strong>Please Note:</strong> Examiners should utilize information contained in the Own Risk</td>
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<td>and Solvency Assessment (ORSA) provided by insurers that are subject to this</td>
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<td>filing requirement.</td>
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- Obtain evidence of the capital modeling calculations performed by management, including self-validation efforts.
- Review the board of directors’ (or committee thereof) meeting minutes for evidence of the board’s approval of the capital modeling results.
- Obtain evidence of financial projections and planning by management.
- Review the board of director meeting minutes for evidence of board review and approval.
- Review the insurer’s capital modeling and evaluate the appropriateness of input assumptions, methodologies and considerations used in quantifying available capital and risk capital. In the case of stochastic or deterministic modeling, document consideration of appropriateness of diversification of risks.
- Review the underlying assumptions found in the financial projections for reasonableness. Review prior year projections for a comparison of assumptions and whether management is historically on target.
<table>
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<tr>
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<th>Possible Detail Tests</th>
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| sufficient capital to support its ongoing and future business needs. ¹ | LQ CR OP | AC EX VA PD CMT | The insurer monitors assets to ensure the quality of capital will support its ongoing business needs. Underlying assets to be considered may include:  
- Deferred tax assets  
- Significant receivables  
- Goodwill  
- Investment in subsidiary  
- Encumbered assets | Verify the insurer’s process to monitor the quality of underlying assets in relation to required capital needs. | Verify the accuracy of reported amounts for selected assets to determine the quality as they support the insurer’s surplus. Include consideration of the liquidity of the assets under review. | Review the make-up of the insurer’s capital and assess how the categories (e.g., |

Please Note:  
Examiners should utilize information contained in the Own Risk and Solvency Assessment (ORSA) provided by insurers that are subject to this filing requirement.

Please Note:  
When the source of capital is from an affiliate, consider testing in conjunction with the Related Party Repository.

The insurer periodically evaluates its gross leverage and adjusts, as needed.

Review documentation of gross leverage limits and evidence of senior management review/approval.

Review the reasonableness of the insurers gross leverage limit by benchmarking against industry standards.

Financial Reporting Risks

The underlying quality of the company’s capital is not sufficient to support its ongoing and future business operations.

| Financial Reporting Risks | LQ CR OP | AC EX VA PD CMT | The insurer monitors assets to ensure the quality of capital will support its ongoing business needs. Underlying assets to be considered may include:  
- Deferred tax assets  
- Significant receivables  
- Goodwill  
- Investment in subsidiary  
- Encumbered assets | Verify the insurer’s process to monitor the quality of underlying assets in relation to required capital needs. | Verify the accuracy of reported amounts for selected assets to determine the quality as they support the insurer’s surplus. Include consideration of the liquidity of the assets under review. | Review the make-up of the insurer’s capital and assess how the categories (e.g., |

Please Note:  
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<th>Possible Detail Tests</th>
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<tr>
<td>Defined benefit pension asset</td>
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<td>The insurer maintains documentation regarding permitted practices that could impact the quality of available capital and reviews all associated calculations to ensure compliance.</td>
<td>Obtain documentation of the insurer’s review of its compliance with permitted practices.</td>
<td>Obtain and review the insurer’s supporting workpapers to test whether material values in the RBC report were properly classified, valued and included (e.g., catastrophe risk exposure data, C-3 Phase II). (This procedure may only be necessary for values not obtained directly from the annual financial statement and not subject to the NAIC RBC crosscheck procedures.)</td>
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<td>The insurer is not accurately calculating, reporting and monitoring RBC.</td>
<td>OP</td>
<td>CM</td>
<td>CMT</td>
<td>RBC calculations are performed in accordance with instructions and subject to supervisory review. The company has a process to ensure that RBC reports and supporting data are filed with the NAIC in a timely and complete manner.</td>
<td>Test controls relating to the insurer’s supervisory review process for RBC.</td>
<td>Determine the impact of examination changes on the RBC calculation.</td>
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<td>The company reconciles data filed in support of the RBC calculation back to system data and/or source.</td>
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<td>Compare the modeling approaches, assumptions and data filed in support of</td>
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<td>Identified Risk</td>
<td>Branded Risk</td>
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<td>same modeling</td>
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<td>data to determine</td>
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<td>significant</td>
<td>components of RBC</td>
<td>purposes. Investigate</td>
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<td>components of its</td>
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<td>risk exposure, C-3</td>
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Annual Statement Blank Line Items

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

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

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

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

Relevant Statements of Statutory Accounting Principles (SSAPs)

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

No. 2R Cash, Cash Equivalents, Drafts, and Short-Term Investments
No. 7 Asset Valuation Reserve and Interest Maintenance Reserve
No. 21R Other Admitted Assets
No. 23 Foreign Currency Transactions and Translations
No. 26R Bonds
No. 30R Unaffiliated Common Stock
No. 32R Preferred Stock
No. 34 Investment Income Due and Accrued
No. 37 Mortgage Loans
No. 38 Acquisition, Development and Construction Arrangements
No. 39 Reverse Mortgages
No. 40R Real Estate Investments
No. 41R Surplus Notes
No. 43R Loan-Backed and Structured Securities
No. 44 Capitalization of Interest
No. 48 Joint Ventures, Partnerships and Limited Liability Companies
No. 49  Policy Loans
No. 56  Separate Accounts
No. 74  Insurance-Linked Securities Issued Through a Protected Cell
No. 83  Mezzanine Real Estate Loans
No. 86  Derivatives
No. 90  Impairment or Disposal of Real Estate Investments
No. 93  Low-Income Housing Tax Credit Property Investments
No. 97  Investments in Subsidiary, Controlled and Affiliated Entities
No. 103R  Transfers and Servicing of Financial Assets and Extinguishments of Liabilities

† Items with this symbol may warrant additional procedures or consideration at the Head of the Internationally Active Insurance Group (IAIG) or level at which the group manages its aggregated risks. Refer to Section 1, Part I for additional guidance for examinations of IAIGs.
<table>
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<tr>
<th>Identified Risk</th>
<th>Branded Risk</th>
<th>Exam Asrt.</th>
<th>Critical Risk</th>
<th>Possible Controls</th>
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<tbody>
<tr>
<td>The insurer’s investment portfolio and strategy are not appropriately structured to support its ongoing business plan†.</td>
<td>MK CR</td>
<td>Other</td>
<td>AIPS LC</td>
<td>The insurer has a governance structure that routinely challenges, approves and reviews its investment strategy and portfolio in conjunction with the risks facing the business. The insurer considers, current market conditions (including interest rates) and takes into account shifting markets and near-term expectations. The insurer has an investment strategy based on its tolerance for market risks (including market price volatility, securities lending and interest rate risks) with guidelines as to the quality, maturity/duration, expected rates of return, different investment structures and diversification of investments. The insurer has an investment strategy that includes a counterparty risk appetite statement, if applicable, and outlines asset allocation by asset type, credit quality, duration and liquidity, with acceptable ranges based on the different investments.</td>
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<td></td>
<td>Review the insurer’s investment committee and governance structure related to the portfolio decisions. Consider level of expertise in relation to the complexity of the company’s investment strategy, as appropriate. Review recent committee minutes for evidence of discussions related to future market expectations. Review the insurer’s investment policy to determine if guidelines relating to the quality, maturity and diversification of investments in accordance with market risk factors have been included in the policy. Review how the insurer tracks performance of different asset classes, with a particular focus on market value volatility and losses/impairments.</td>
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<td>Review the insurer’s investment policy guidelines for appropriateness relating to market risks. Determine whether market risk management specific to high-risk investments is adequate by using an investment specialist. Use the I-Site+ insurer's Snapshot Investment Summary to identify high risk investments where the company’s position is greater than average for its competitors in areas such as: - Bonds with call options and varied payment timing. - Foreign investments. - Hybrid capital securities. - Mezzanine loans. - Affiliated investments. - Residential mortgage-backed securities (RMBS), commercial mortgage-backed securities (CMBS), asset-backed securities.</td>
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<tr>
<td>Identified Risk</td>
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<td>and their specific characteristics. Correlations across different assets are considered within the strategy.</td>
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<td>The insurer performs routine stress testing and/or scenario analysis that specifically takes into account recent and expected market value volatility by sector and industry in order to determine whether adjustments to the insurer’s investment strategy are necessary.</td>
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<td>The insurer has its own process that is not solely dependent upon credit rating agencies to evaluate the credit worthiness of securities for investment purposes. The process is used prior to significant purchases and on an ongoing basis.</td>
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<td>The insurer’s investment strategy considers the impact of, and market expectations for, climate change on different investments, and the investment policy includes guidelines that require</td>
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<td>Identified Risk</td>
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| diversification to protect against the impact of climate change. | The insurer’s/group’s investment strategy establishes criteria for intra-group investments, when applicable, including:  
• Liquidity  
• Contagion or reputational risk  
• Valuation uncertainty  
• Impact on capital resources  
• Nature of the group (or IAIG) business  
• Financial condition of the legal entities within the group. | The board of directors (or committee thereof) and management do not effectively implement/enforce the investment policy/strategy†. | OP ST | Other | AIPS | Inspect documentation indicating the board of directors’ (or committee thereof) approval of the insurer’s investment policy on an annual basis. Consider the level of expertise in relation to the complexity of the company’s investment strategy, as appropriate.  
Obtain a copy of the report that is used by the insurer to report investment policy compliance to the board of directors (or committee thereof), and verify the  
Review written policy for reasonableness. | Obtain the underlying reports used by the board of directors (or committee thereof) to review the investment strategy results. Discuss with members of the board of directors (or committee thereof) to determine their level of involvement in the monitoring of the investment strategy/risks. Determine if there is sufficient focus on all relevant investment risks. |
<table>
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<tr>
<th>Identified Risk</th>
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<th>Possible Test of Controls</th>
<th>Possible Detail Tests</th>
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<tbody>
<tr>
<td>The board of directors (or committee thereof) and management do not effectively monitor or supervise contracted third parties in the implementation of the investment policy/strategy.</td>
<td>CR MK</td>
<td>Other</td>
<td>AIPS</td>
<td>Prior to entering into a contract with a third party, management reviews the third party’s credentials to ensure that they are qualified to perform the service and verifies that no conflict of interest exists. Management ensures that third-party contracts include appropriate provisions and recognize fiduciary responsibility to the insurer.</td>
<td>Review procedures that ensure management reviews the credentials, including confirming registration as investment advisor/manager, of the third party and that no conflict of interest exists. Verify the insurer control to ensure appropriate contract provisions. Specifically consider any situations and transactions where the</td>
<td>Assess the suitability of investment advisers through a review of information provided to the U.S. Securities and Exchange Commission (SEC) in Form ADV (if available) or other available information. Determine if there are any disciplinary actions or background information that might call into question the advisers’ suitability for providing services rendered.</td>
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*See Section 1 Part III of the Handbook for additional guidance*
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<td>relevant to reviewing third-party investment advisers and associated contractual arrangements.</td>
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<td>Contracts are reviewed for appropriate provisions related to:</td>
<td>potential of conflict of interest exists. This includes transactions with other accounts managed by the third-party manager, through brokers affiliated with the third-party manager and investments in funds managed separately by the third-party manager.</td>
<td>Review significant investment advisory/management agreements for appropriate provisions.</td>
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<td>• Investment guidelines/selection.</td>
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<td>Review recent performance and benchmark reports in comparison with the company’s plan.</td>
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<td>• Authority for transactions.</td>
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<td>Test the insurer’s investments for compliance with its investment policy guidelines.</td>
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<td>• Reporting of transactions in sufficient detail and frequency.</td>
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<td>Assess significant changes in portfolio profile year over year and over the course of recent years to determine suitability of changes for the company.</td>
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<td>• Conflicts of interest.</td>
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<td>• Appropriateness of fees.</td>
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<td>• Review of performance.</td>
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<td>• Termination.</td>
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<td>The insurer monitors investments purchased, those sold, the performance of the investment portfolio against prior year or budgeted results, and what the insurer holds. It also monitors compliance with the investment strategy that has been established by the board of directors (or committee thereof). This monitoring can be performed by senior management, an investment advisory board or internal auditors and is reported to the board of directors (or committee thereof).</td>
<td>Obtain a copy of the report that is used by the insurer to report investment policy compliance to the board of directors (or committee thereof), and verify the board’s review of the investment activity.</td>
<td>Obtain a copy of the report that is used by the insurer to report investment policy compliance to the board of directors (or committee thereof), and verify the board’s review of the investment activity.</td>
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<td>The insurer has a plan in place that documents the management has adequately reviewed the insurer’s non-</td>
<td>Determine whether management has adequately reviewed the insurer’s non-</td>
<td>If necessary, use an investment specialist to analyze the insurer’s</td>
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<td>The insurer is not properly implementing and</td>
<td>MK CR</td>
<td>Other</td>
<td>AIPS VIIA</td>
<td>place that documents the</td>
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<td>monitoring structured security transactions.</td>
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<td>following for its structured security portfolio:</td>
<td>agency structured security portfolio for the following risks:</td>
<td>structured securities portfolio.</td>
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<td><strong>Please note:</strong> If the company appears to have significant structured security holdings, consider engaging a specialist to conduct a portfolio analysis to assist in identifying and assessing risks in this area.</td>
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<td>• Strategy.</td>
<td>• Complex cash-flow structures (including interest-only and prepayment support structures).</td>
<td>Review a sample of structured securities to test for proper valuation.</td>
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<td>• Relation to products.</td>
<td>• Sub-prime borrowers within the underlying assets (e.g., mortgage loans, auto loans, credit cards, etc.).</td>
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<td>• Senior management review and board of directors (or committee thereof) oversight.</td>
<td>• Collateral type concentration.</td>
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<td>• Major adverse factors and frequency of stress testing.</td>
<td>• Subordination in the overall structure of the transactions.</td>
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<td>Management reviews and considers prepayment volatility and cash-flow variability with regards to mortgage-backed securities in implementing its investment strategy.</td>
<td>• Trend analysis (underlying assets).</td>
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<td>The insurer has a process in place to understand the reporting and valuation techniques discussed in SSAP No. 43R for complex structured securities.</td>
<td>Review the insurer’s process to determine the valuation of complex structured securities.</td>
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<tr>
<td>Investment returns are not sufficient to meet the risks assumed in</td>
<td>LQ CR MK</td>
<td>Other</td>
<td>AIPS</td>
<td>The insurer has a process in place in which its risk/reward strategy is</td>
<td>Gain an understanding of how the insurer reviews its risk/reward strategy. Test</td>
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<td>risk/reward strategy is</td>
<td>Test the data inputs used within the model(s) to</td>
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<td>the insurer’s investment portfolio and the company’s business strategy.</td>
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<td>reviewed on a regular basis. This may be performed through the use of optimization models.</td>
<td>the controls over this process for operating effectiveness.</td>
<td>ensure accurate information was utilized.</td>
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<td>The insurer prepares projections outlining expectations for specific asset classes, planned performance measures and benchmarks. Reports reflect performance during a set period of time along with a comparison to historical results, plan and benchmarks.</td>
<td>Review the insurer’s process to relate investment risk into its overall enterprise risk management (ERM) framework. Review the projections for specific asset classes and the asset performance reports, and verify management oversight and approval.</td>
<td>Review assumptions used in model(s) for different risk factors (i.e., interest rate and volatility) for reasonableness.</td>
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<td>The insurer has an established governance and reporting structure related to the evaluation of investment risk/reward within specific asset classes. This includes frequent monitoring of investment returns considering specific asset class performance, and benchmarking to industry statistics is considered when evaluating investment returns.</td>
<td>Review investment committee presentations, meeting minutes and portfolio reports related to the investment function. Determine whether management approves and reviews investment returns, considering specific asset classes, on a regular basis.</td>
<td>Review the appropriateness of the insurer’s risk/reward strategy for investments, with the assistance of an investment specialist if necessary.</td>
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<td>The company considers product guarantees and yield assumptions in both pricing and reserving in setting and updating its investment strategy.</td>
<td>Review the insurer’s process to confirm if it is considering product guarantees and yield assumptions, as appropriate.</td>
<td>Obtain industry data for peer companies, and compare asset class performance during a set period of time (i.e., benchmarking vs. industry data).</td>
</tr>
<tr>
<td></td>
<td>MK CRST</td>
<td>Other AIPS</td>
<td>The insurer has properly adopted a derivative use</td>
<td>Review how management ensures that its derivative</td>
<td>Consider using an investment specialist to</td>
<td>Compare the company’s actual yield with guaranteed crediting rates, as well as with significant pricing and reserve assumptions to determine if investment spread is sufficient for ongoing operations.</td>
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Note: The table continues with additional entries and columns, but they are not fully visible in the provided excerpt.
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</table>
| implementing and monitoring derivative transactions. | OP | | | plan within the investment policy approved by the board of directors (or committee thereof), which includes the following attributes:  
- Management controls.  
- Type and use limits.  
- Relationship to overall investment limits.  
- Documentation and reporting requirements.  
- Valuation procedures.  
- Quantitative limits.  
- Risk management standards.  
- Compliance with applicable state law, internal policy and NAIC practices.  
- Margin requirements.  

The insurer frequently reviews its derivative position to determine effectiveness of hedging and replication transactions and adjusts where necessary.  

The insurer periodically evaluates the financial condition and capabilities of its approved counterparties. Based on this review, the insurer sets and regularly reviews counterparty credit limits.  

use plan is complete and in compliance with applicable laws and best practices.  

Determine whether the insurer’s derivative traders are part of its larger risk-management organization and not a profit center.  

Determine whether the company effectively implements its derivative strategy by performing a walk-through with investment staff. Inquire as to how they ensure that derivative agreements are in line with the strategy and objectives of the insurer.  

Review management control procedures for determining effectiveness of hedging and replication transactions for adequacy.  

Inspect documentation evidencing the insurer’s review of its counterparties’ financial condition and updates to credit limits that are based thereon.  

assist with detail test procedures.  

Review the insurer’s derivative use policy guidelines for appropriateness.  

Perform a review of the insurer’s derivative position to ensure it is in compliance with the hedging and replication strategies outlined in the derivative use plan.  

Select a sample of derivatives, and review the following attributes for compliance with the company’s plan:  
- Valuation.  
- Effectiveness.  
- Legal review.  
- Accounting compliance.  
- Maturity reasonableness (i.e., not long dated).  

Review hedge performance for periods of market volatility.  

Review the financial condition and capabilities of key counterparties of the insurer. |
<table>
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<td>Automated controls are in place to prevent the insurer from entering into a transaction with an unapproved counterparty or a transaction exceeding a counterparty’s approved credit limit.</td>
<td>Observe automated controls that prevent transactions with unapproved counterparties or above a counterparty’s credit limit. Observe limits to any override authority (may be verified through an information technology [IT] auditor).</td>
<td>Review a sample of collateral positions for compliance with limits. Validate compliance with the NAIC List of Qualified U.S. Financial Institutions available on the Securities Valuation Office’s (SVO) web page.</td>
</tr>
<tr>
<td>The insurer is not properly implementing and monitoring security lending, repurchase and reverse repurchase transactions.</td>
<td>CR LQ OP</td>
<td>Other</td>
<td>AIPS LC</td>
<td>Insurer management implements controls over credit, market, and operational risk associated with securities operations, which include monitoring the following:  • Percentage and type of securities permitted to be loaned.  • Borrower (counterparty) concentration and credit worthiness.  • Amount of collateral and systematic true-up.  • Investment of cash collateral. The insurer has established a securities lending framework based on its tolerance for market risks (including market price volatility and interest rate risks) and has included guidelines as to the internal procedure for adequacy:  • Internal approvals.  • Regulatory framework.  • Contractual agreements.  • Counterparty management.</td>
<td>Review management’s lending program and methods to compare it to actual operations. Determine how management ensures that the lending program complies with state laws, regulation, internal policy and NAIC practices. Review management controls for reinvestment of collateral focusing on market value volatility and liquidity of the reinvested assets, and on the duration of the reinvested assets with the duration of the securities lending agreement. Evaluate the following internal procedures for adequacy:  • Internal approvals.  • Regulatory framework.  • Contractual agreements.  • Counterparty management.</td>
<td>Review guidelines for any securities lending programs deemed off balance sheet. Review maturity and duration of reinvested collateral in comparison to the stated term of the lending agreements and potential liquidity shortfalls individually by counterparty.</td>
</tr>
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<td>Identified Risk</td>
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</table>
| The insurer may not effectively manage its asset duration to match its future liabilities. | LQ ST | Other | AIPS | - Program size and composition.  
- Lending strategies.  
- Reinvestment strategies.  
- Risk measurements. | Obtain documentation to evidence the insurer is reviewing the matching of assets and liabilities, and test for effectiveness as follows:  
- Verify the insurer has a process in place to determine the expected liability durations and to check the impact of any asset/liability mismatch.  
- Review maximum asset/liability mismatch duration allowed for reasonableness.  
- Verify asset data used for compliance of policy.  
- Verify that the duration mismatches are not allowed to go outside of set parameters. | Test the assumptions used in the asset and liability matching analysis.  
Determine whether the assumptions are reasonable based on overall economic and company historical and trend data, and validate that the company’s illiquid assets (including private placements, non-marketable fund investments, real estate related assets, special deposits/restricted assets and affiliate investments) were all considered in its analysis.  
Verify underlying data used to analyze the matching of assets and liabilities using the pricing documents showing liability durations, and the Actuarial Opinion Memorandum showing asset and liability cash flows.  
If necessary, use an investment specialist and/or actuary to analyze the insurer’s asset/liability matching. |

IX. Identification and Management of Significant Risks

The insurer has a process in place in which assets and liabilities are reviewed to ensure the insurer has enough cash inflows and assets convertible into cash to pay obligations. This should include consideration of call, extension and deferral (i.e., duration) of the assets, prepayment volatility of mortgage-backed securities liquidity and market value volatility.

Actuaries document for investment staff the duration of the liabilities through economic scenario testing. The company has a process in place to adjust its investment strategy to match the documented duration.

The insurer has a governance structure that routinely challenges, approves and reviews the asset/liability matching activities of the insurer, taking into account recent and expected shifts in markets.

Ensure that the company considers call, extension and deferral risk, and prepayment variability of mortgage-backed securities in its duration planning.
<table>
<thead>
<tr>
<th>Identified Risk</th>
<th>Branded Risk Asrt.</th>
<th>Exam</th>
<th>Critical Risk</th>
<th>Possible Controls</th>
<th>Possible Test of Controls</th>
<th>Possible Detail Tests</th>
</tr>
</thead>
<tbody>
<tr>
<td>The insurers do not review its liquidity position to determine if adjustments are necessary to meet its potential near-term cash flow needs.</td>
<td>OP ST LQ</td>
<td>Other</td>
<td>LC</td>
<td>The insurer has a liquidity measurement, monitoring and management framework that includes a written liquidity plan with contingency and stress-testing features.</td>
<td>Determine whether management’s review of the liquidity plan and stress testing procedures and assumptions is reasonable considering its experience and market history.</td>
<td>Validate that the company’s illiquid assets (including private placement, non-marketable funds, real estate-related assets, special deposits/restricted assets, and affiliate investments) were all considered, and determine whether it relies heavily upon nontraditional or non-insurance activities (e.g., commercial paper and securities lending) for liquidity.</td>
</tr>
</tbody>
</table>

**Please Note:**
Examiners may wish to refer to the Exam Planning Questionnaire section on liquidity (Exhibit B, Section IV, Part J)
### Identified Risk

<table>
<thead>
<tr>
<th>Branded Risk</th>
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<td>to assist in identifying and assessing potential risk in this area.</td>
<td>Validate company liquidity testing to confirm results under stressed scenarios.</td>
<td>If necessary, use an investment specialist and/or actuary to analyze the insurer’s liquidity position.</td>
</tr>
</tbody>
</table>

### Financial Reporting Risks

<table>
<thead>
<tr>
<th>MK</th>
<th>VA</th>
<th>VIIA</th>
</tr>
</thead>
<tbody>
<tr>
<td>The insurer’s bonds, stocks and short-term investments that are considered hard-to-value, high-risk and/or subject to significant price variation are incorrectly valued.</td>
<td>The insurer reconciles its investments to the statements received from its investment managers/custodians on a regular basis.</td>
<td>Inspect reconciliations of the insurer’s recorded investments to the investment statements received from investment managers/custodians.</td>
</tr>
<tr>
<td>In the event the insurer manages its own investments, it obtains pricing information from a recognized independent source, such as Bloomberg.</td>
<td>Test the controls in place surrounding the independent pricing process to determine whether guidelines (mid-market, bid, ask) are reasonable and consistently applied.</td>
<td>Review Jumpstart investment exception reports to determine whether the company’s quality assurance controls were functioning for accurate Committee on Uniform Security Identification Procedures (CUSIP), designation and market values.</td>
</tr>
<tr>
<td>The insurer periodically reviews the prepayment and default assumptions for loan-backed securities and evaluates the proper valuation per SSAP No. 43R.</td>
<td>Review the insurer’s process to review prepayment assumptions for loan-backed securities, and inspect relevant documents as necessary.</td>
<td>Confirm the value of securities with investment managers/custodians, and agree the amount confirmed to the insurer’s records.</td>
</tr>
<tr>
<td>The insurer has procedures in place to review for wash sales and to determine whether they have been properly valued and disclosed in accordance with SSAP No. 103R.</td>
<td>Review the insurer’s procedures for identifying wash sales, including its listing of such sales. Ensure that this list is updated at least on a quarterly basis and is properly reviewed by the insurer.</td>
<td>Select a sample of pricing of securities, and verify quotes with other independent sources.</td>
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<td>Review insurer assumptions for reasonableness.</td>
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<td></td>
<td>Review the insurer’s investment transactions to test the completeness of the insurer’s listing of wash sales. If wash sales are</td>
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<td>Identified Risk Risk</td>
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<td>Critical Risk</td>
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<tr>
<td>The insurer has a process in place to ensure the correct currency conversion is used in accordance with SSAP No. 23.</td>
<td>CR LQ</td>
<td>VA PD</td>
</tr>
<tr>
<td>If investment transaction services are outsourced, the insurer either audits the performance of its service providers on a regular basis or obtains and reviews a Service Organization Control (SOC) 1 report on a regular basis.</td>
<td>CR LQ</td>
<td>VA PD</td>
</tr>
<tr>
<td>The insurer may not properly write down the value of securities that are other than temporarily impaired.</td>
<td>CR LQ</td>
<td>VA PD</td>
</tr>
<tr>
<td>Written policies and procedures provide guidance to determine other-than-temporarily impaired (OTTI) securities. Potential impairments are identified on a watch list to provide a heightened level of management oversight.</td>
<td>CR LQ</td>
<td>VA PD</td>
</tr>
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<td>Identified Risk</td>
<td>Branded Risk</td>
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</tr>
<tr>
<td>The investments in high-risk mortgage loans are incorrectly valued.</td>
<td>CR LQ MK</td>
<td>VA CO</td>
</tr>
<tr>
<td>Identified Risk</td>
<td>Branded Risk</td>
<td>Exam Asrt.</td>
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</tr>
<tr>
<td>The insurer is not properly identifying, handling and recording foreclosed mortgage loans.</td>
<td>CR MK LQ</td>
<td>AC CO VA PD</td>
</tr>
</tbody>
</table>

- Current appraisals are maintained by the insurer.

- Obtain the master schedule that states when appraisals need to be updated for each mortgage loan the insurer holds as an investment (in accordance with SSAP No. 37). Ensure that this schedule is monitored and updated prior to when the latest appraisal comes due.

- Take the total 180 days past due report, and agree it to the amount written off within the balance sheet.

- Obtain a master schedule of appraisal dates. Select a sample of mortgages to test and ensure the most current appraisal has been obtained and is located within the file. Ensure that a sample of the insurer’s appraisers have a Member Appraisal Institute (MAI) certification or equivalent appraiser certifications, as applicable.*

- The insurer has a process in place to identify loans in default and foreclose on the loans appropriately.

- Obtain an understanding of the insurer’s process to identify loans in default and foreclose appropriately. Test the operating effectiveness of this process by inspecting the respective documents.

- Obtain an understanding of the process to record impairments. Test the operating effectiveness.

- Compare loans with high adjusted loan-to-values and/or low debt service coverage ratios with the insurer’s listing of loans in default for accuracy and completeness.

- Obtain a listing of foreclosed mortgage loans.

- Review management’s calculations resulting from impairments to mortgage loans for appropriateness.
<table>
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</table>
| The insurer’s investments in joint ventures, partnerships and limited liability companies are incorrectly valued. | MK           | VA         | VIIA          | The insurer has a process in place to record its investments using the statutory equity method, in accordance with SSAP No. 48. For minority ownership interests (less than 10%), the insurer has a process in place to record investments using the audited GAAP equity method, also in accordance with SSAP No. 48. The insurer has a process in place to determine the correct ownership percentage of its joint ventures, investments in partnerships and limited liability companies. | Review the insurer’s process to record investments in joint ventures, limited liability companies and partnerships. Determine whether the process is operating effectively and in accordance with SSAP No. 48 guidance. | Review cash flows received from the investments, and compare with expected returns. Obtain a listing of joint ventures, limited liability companies and partnerships. Select a sample and test the following:  
- Valued in accordance with SSAP No. 48.  
- Completely reported, including commitments for additional funding requirements on the investment schedules and notes.  
- Supported by investment reports that are audited and are documented in detail and complete.  
- Calculations of income versus gains and losses are accurately reported in investment schedules and notes.  
- Obtain an independent statement that confirms the insurer’s ownership percentage. Ensure the confirmed percentage amount agrees to the insurer’s stated percentage. |
<table>
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<tr>
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</thead>
<tbody>
<tr>
<td>The value and presentation of loaned securities, repurchase and reverse repurchase agreements are incorrect.</td>
<td>OP MK</td>
<td>VA PD</td>
<td>V IIA</td>
<td>The insurer has a process in place to ensure that the collateral is properly valued and maintained at the appropriate level. The value of the collateral is maintained at or more than 102% of the market value of the loaned securities or 95% of the market value of repurchase agreements. The collateral is not restricted, and the insurer follows the accounting treatment outlined in SSAP No. 103R.</td>
<td>Test the insurer’s process in place to ensure collateral is held at or more than 102% for each loaned security for operating effectiveness or 95% of the market value of repurchase agreements. Test the insurer’s controls regarding compliance with SSAP No. 103R.</td>
<td>Test a sample of the collateral balances (through confirmation or review of collections) to ensure that they are maintained at or more than 102% of the market value of the loaned securities.* For the same sample selection, test to ensure the securities are not restricted.* Based on the results of the testing above, determine whether the insurer is applying the correct accounting treatment in accordance with SSAP No. 103R. Validate that lent securities are in compliance with state laws, regulation, internal policy and NAIC practices. Review a sample of netting agreements by counterparty, positive vs. negative positions (i.e., amounts due versus amounts owed) and collateral pledged vs. collateral held to ensure appropriate accounting.</td>
</tr>
<tr>
<td>The insurer is not properly evaluating, valuing and recording derivative transactions.</td>
<td>CR MK OP ST</td>
<td>AC VA CO PD</td>
<td>V IIA</td>
<td>Management reviews derivative reports in a timely manner to ensure compliance with its current accounting practices and procedures. As such,</td>
<td>Confirm management uses control best practices and it includes review of the derivative valuation process, especially for over-the-counter derivatives to</td>
<td>Review Schedule DB to ensure it is accurate and complete, including the following attributes:</td>
</tr>
</tbody>
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<p>| Attachment A |</p>
<table>
<thead>
<tr>
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<td>management ensures that derivatives are accurately and completely recorded in compliance with SSAP No. 86, internal policy and state law.</td>
<td>ensure that it is robust and transparent for derivatives that have no published daily exchange price. Ensure that it includes all derivatives that have unusual or complex terms.</td>
<td>• Trades are recorded shortly after the trade is made. • Financial results of the trade are accurately reported.</td>
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<td>Management implements controls as follows: • Mandatory trader vacation policy. • Review of gross trading positions. • Monitor any cancel &amp; correct, as-of, amendment and off-market transactions. • Monitor trades done with unspecified counterparties and unconfirmed and unmatched trades. • Reports of market risk profit and loss look-backs. • Treasury review of derivative activity. • Reports compliance with derivative use plan, statutory limits and policies on a timely basis.</td>
<td>Ensure there is a segregation as follows: • Traders do not have access to financial reporting or trade clearance functions. • Insurer and third-party funds. • Ensure that the company has adequate reporting capabilities for testing compliance with limits and policies.</td>
<td>Select a sample of open derivative transactions, and confirm them directly with counterparties. If necessary, use an investment specialist to analyze and/or value the insurer’s derivative holdings.</td>
</tr>
<tr>
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<td>The insurer has implemented controls over the maintenance of collateral associated with open derivative positions.</td>
<td>Review processes and controls over the determination and recording of collateral received from or to counterparties to mitigate the risk of</td>
<td>Review compliance with limits and policies for a sample of reporting dates. Recalculate collateral requirements based upon the terms of derivative contracts and periodic valuation of open positions. Trace collateral transfers to statements or other correspondence from or to counterparties.</td>
</tr>
<tr>
<td></td>
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<td></td>
<td>The insurer has implemented controls over the maintenance of collateral associated with open derivative positions.</td>
<td>Review and consider gross and net exposures with counterparties.</td>
<td></td>
</tr>
<tr>
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</tr>
<tr>
<td>The insurer is not properly valuing investments in subsidiary, controlled and affiliated (SCA) entities.</td>
<td>MK LQ</td>
<td>PD AC VA</td>
<td>RPHCC</td>
<td>The insurer has procedures in place to value its investments in SCA entities to ensure compliance with the requirements of SSAP No. 97.</td>
<td>Review valuation procedures for investments in SCA entities to ensure that the investments are properly valued.</td>
<td>Perform a review of investments in SCA entities to ensure they meet the requirements of SSAP No. 97.</td>
</tr>
</tbody>
</table>
Annual Statement Blank Line Items

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

- Reinsurance Payable on Paid Loss and Loss Adjustment Expenses
- Funds Held by the Company Under Reinsurance Treaties
- Contract Liabilities Not Included Elsewhere – Other Amounts Payable on Reinsurance
- Commissions and Expense Allowances Payable on Reinsurance Assumed

Relevant Statements of Statutory Accounting Principles (SSAPs)

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

- No. 5R Liabilities, Contingencies and Impairments of Assets – Revised
- No. 6 Uncollected Premium Balances, Bills Receivable for Premiums, and Amounts Due from Agents and Brokers
- No. 25 Affiliates and Other Related Parties
- No. 61R Life, Deposit-Type and Accident and Health Reinsurance – Revised
- No. 62R Property and Casualty Reinsurance – Revised
- No. 63 Underwriting Pools
- No. 64 Offsetting and Netting of Assets and Liabilities
- No. 65 Property and Casualty Contracts

Note: Risks within this key activity may warrant additional procedures or consideration at the Head of the Internationally Active Insurance Group (IAIG) or level at which the group manages its aggregated risks. Refer to Section 1, Part I for additional guidance for examinations of IAIGs.
<table>
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<tr>
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<tbody>
<tr>
<td>The (re)insurer does not have or is not complying with its reinsurance strategy†.</td>
<td>OP ST</td>
<td>Other</td>
<td>UPSQ</td>
<td>The (re)insurer has a documented strategy that indicates the type of reinsurance to be offered and the guidelines for ceding companies to meet, which is approved by the board of directors (or committee thereof).</td>
<td>Review meeting minutes of the board of directors (or committee thereof) or other evidence of board involvement in the approval of the (re)insurer’s reinsurance strategy.</td>
<td>Review assuming agreements to determine whether the lines, types and limits of business assumed conform to the (re)insurer’s reinsurance strategy.</td>
</tr>
<tr>
<td>The (re)insurer is not properly evaluating and monitoring the ceding insurer for compliance with guidelines outlined in the reinsurance strategy.</td>
<td>OP ST</td>
<td>Other</td>
<td>UPSQ</td>
<td>The (re)insurer has a formal process in place to review and approve reinsurance agreements for compliance with the company’s documented strategy.</td>
<td>Obtain and review documented reinsurance strategy.</td>
<td>Select a sample of new reinsurance contracts for evidence of review and approval in accordance with the insurer’s process.</td>
</tr>
<tr>
<td>The (re)insurer does not collect accurate and complete loss exposure data from</td>
<td>OP ST</td>
<td>Other</td>
<td>UPSQ</td>
<td>Prior to entering into contracts, the (re)insurer performs due diligence on the potential ceding insurers to ensure compliance with the reinsurer’s underwriting and claims practices.</td>
<td>Obtain documentation of the (re)insurer’s due diligence and consider whether the work completed is appropriate.</td>
<td>Review analytically the results of ceding insurers to evaluate their underwriting and claims practices.</td>
</tr>
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<td></td>
<td>AARP RD</td>
<td></td>
<td></td>
<td>Throughout the term of the contract, the (re)insurer periodically reviews the underwriting practices and evaluates the underwriting and claims results of ceding insurers through analytical reviews and/or quality assurance (QA) reviews.</td>
<td>Obtain documentation of the (re)insurer’s periodic reviews of ceding insurers.</td>
<td></td>
</tr>
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<tr>
<td>ceding insurers/brokers. (See also Examination Repository – Reserves/Claims Handling.)</td>
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<td></td>
<td>its ceding insurer/brokers.  • The process includes consistency checks/variance analysis in reviewing reported data; and • The (re)insurer conducts periodic audits of ceding companies to review reported loss exposure data and other significant reporting elements.</td>
<td>loss exposure data reported by ceding insurers/brokers.</td>
<td>inconsistencies. If deemed necessary, perform additional procedures to get comfort with the loss exposure data reported to the (re)insurer from ceding insurers/brokers.</td>
</tr>
<tr>
<td>The (re)insurer has not established and maintained appropriate risk exposure limits for assuming reinsurance.</td>
<td>OP ST</td>
<td>Other</td>
<td>UPSQ</td>
<td>The (re)insurer has established and documented risk exposure limits by geography and/or line of business that have been reviewed and approved by senior management. The (re)insurer utilizes a fully staffed, well-qualified reinsurance department that has experience in all lines of business and geographic locations served by the (re)insurer. The (re)insurer accumulates assumed loss exposure data and utilizes data models to track compliance with exposure limits established by the (re)insurer.</td>
<td>Review documentation of risk exposure limits and evidence of senior management review/approval. Review the credentials, background and responsibilities of the senior personnel managing the insurer’s reinsurance function. Test the operating effectiveness of the (re)insurer’s controls to accumulate loss exposure data and track compliance with the exposure limits established by the (re)insurer.</td>
<td>If necessary, recalculate the aggregate loss exposures by reviewing data reported by ceding insurers/brokers. Utilize audit software to review the (re)insurer’s risk exposures (e.g., summarize policies by ZIP code, industry code, policy size, etc.) for compliance with insurer limits. If the (re)insurer has not identified risk exposure limits, test the risk exposures for appropriateness by considering industry standards.</td>
</tr>
<tr>
<td>The (re)insurer is not monitoring financial results for financially</td>
<td>OP ST</td>
<td>Other</td>
<td>UPSQ</td>
<td>The (re)insurer has procedures in place governing comparison of</td>
<td>Obtain documentation of ongoing monitoring of reinsurance results.</td>
<td>Review treaty files for evidence of ongoing review process.</td>
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<table>
<thead>
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<tr>
<td>significant assumed contracts.</td>
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<td>actual vs. expected for financially significant contracts.</td>
<td></td>
<td>Perform analytical procedures to ensure that significant contracts do not represent a future solvency risk.</td>
</tr>
<tr>
<td>The (re)insurer does not effectively oversee its reinsurance intermediaries to ensure that they are complying with the intermediary agreement.</td>
<td>OP CR</td>
<td>Other</td>
<td>UPSQ</td>
<td>The reinsurer has a written agreement with the intermediary to document the responsibilities of each party.</td>
<td>Review the documentation that provides evidence that a written contract is received and approved.</td>
<td>Review the results of audits performed by the intermediaries (audits of ceding insurers).</td>
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<td>The (re)insurer periodically reviews the processes, procedures and transactions performed by the intermediary to ensure that they are properly negotiating contracts and fulfilling other contractual duties as outlined in the agreement.</td>
<td>Review documentation that provides evidence of periodic review of the intermediary function.</td>
<td>If deemed necessary, perform a site visit to audit the intermediary’s processes and transactions.</td>
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### Financial Reporting Risks

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</thead>
<tbody>
<tr>
<td>Reinsurance contracts are not completed and accounted for in compliance with statutory accounting principles (SAP) and applicable state requirements.</td>
<td>LG PD EX OB/OW</td>
<td>RRC</td>
<td></td>
<td>The reinsurer evaluates all reinsurance contracts to ensure that there is adequate transfer of risk in compliance with SAP.</td>
<td>Gain an understanding of the (re)insurer’s processes for the review of reinsurance contracts and examine contracts for evidence of evaluation.</td>
<td>For all significant contracts, determine whether the contracts include appropriate clauses and transfer risk in accordance with SAP. Use Exhibit N, Part Three to assist in this process.</td>
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<td>Contracts are reviewed to ensure inclusion of adequate collateral and contract provisions as required by SAP.</td>
<td>• For P&amp;C insurers, review the insurer’s policies and procedures in place to 1) determine how the reinsurance agreement is accounted for (prospective, retroactively or deposited in accordance with SSAP No. 62R); and 2) ensure the</td>
<td>If a contract does not transfer risk, verify that it has received deposit accounting treatment in accordance with SAP.*</td>
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<td></td>
<td>All reinsurance contracts are reviewed by the reinsurer’s legal department to ensure that there are no provisions that might adversely affect the</td>
<td></td>
<td>For a sample of P&amp;C reinsurance contracts, determine whether the</td>
</tr>
<tr>
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</tr>
<tr>
<td>assuming insurer.</td>
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<td></td>
<td>The assuming insurer has procedures in place to ensure that reinsurance contracts are finalized, reduced to written form and signed in accordance with applicable SSAPs.</td>
<td>agreement includes required agreement terms.</td>
<td>execution date falls within nine months of the effective date or that the contract is accounted for retroactively in accordance with SSAP No. 62R. For a sample of life reinsurance contracts, determine whether the effective date and the execution date fall within Appendix A-791 requirements.</td>
</tr>
<tr>
<td>• For P&amp;C insurers, contracts must be executed within nine months of effective date or accounted for as retroactive agreements in accordance with SSAP No. 62R.</td>
<td></td>
<td></td>
<td></td>
<td>• For life insurers, credit for reinsurance is not authorized if the agreement, amendment or binding letter of intent is not executed by both parties by the “as-of” date of the financial statement in accordance with Appendix A-791.</td>
<td>• For life insurers, review the insurer’s policies and procedures in place to ensure compliance with Appendix A-791.</td>
<td></td>
</tr>
<tr>
<td>• For life insurers, review the insurer’s policies and procedures in place to ensure compliance with Appendix A-791.</td>
<td></td>
<td></td>
<td></td>
<td>• Determine whether they have been reviewed by Utilize NAIC Examination Jumpstart reports to identify instances where material assumed reinsurance liabilities have not been included in the assuming insurer’s financial statements.</td>
<td></td>
<td></td>
</tr>
<tr>
<td>The (re)insurer is not including all assumed contracts in its financial statements.</td>
<td>OP RV</td>
<td>AC CO PD</td>
<td>RD RRC</td>
<td>The (re)insurer has procedures in place that define the specific authority levels of designated personnel who are authorized to commit the corporation to new reinsurance contracts. The (re)insurer has written guidelines/procedures specifying acceptable documentation, review and</td>
<td>Review a selection of contracts to: • Ensure that only authorized personnel are committing the insurer to reinsurance contracts. • Ensure that the appropriate documentation and approvals are in place.</td>
<td></td>
</tr>
<tr>
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<td>Reinsurance contracts with affiliates have not been filed in accordance with applicable state statutes and do not have equitable contract provisions.</td>
<td>OP ST</td>
<td>CM AC</td>
<td>AARP RPHCC</td>
<td>approval required before a contract may be accepted.</td>
<td>the accounting department for purposes of determining the proper accounting treatment.</td>
<td>Obtain and review the significant contracts between the (re)insurer and its affiliates and ensure that agreements are filed with the insurance department in accordance with applicable state requirements. Verify that the (re)insurer is operating in accordance with approved contract terms.</td>
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<td>The (re)insurer has procedures in place to ensure review of all contracts by the accounting department to ensure proper reporting.</td>
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<td>Review contract provisions for reasonableness through conducting analytical procedures such as reviewing the profitability of business assumed from affiliates and/or comparing commissions paid to the ceding insurer’s expense ratio or comparing actual to expected results.</td>
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<td>The (re)insurer has policies and procedures in place to ensure all contracts with affiliates are filed with the department as required by applicable statutes (Form D filing).</td>
<td>Test the (re)insurer’s processes to ensure that transactions with related parties are negotiated at arm’s length and are in accordance with SAP. These policies ensure that:</td>
<td>Consider involving a reinsurance expert or actuarial examiner to review complex contracts and/or those with questionable</td>
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<td>• Contracts are subject to review and approval by senior management;</td>
<td>• Ceding commissions are commensurate with the nature/quality of the business assumed;</td>
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<td>• Ceding commissions are commensurate with the nature/quality of the business assumed;</td>
<td>• Contract terms comply with SSAP No. 25;</td>
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<td>• Reinsurance is not being used to transfer capital to affiliates; and</td>
<td>• Reinsurance is not being used to transfer capital to affiliates; and</td>
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<td></td>
<td>• Actuarial review is performed prior to</td>
<td>• Actuarial review is performed prior to</td>
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Review the insurer’s policies and procedures in place to ensure such policies adhere to applicable statutes and would adequately identify transactions requiring a filing.

Obtain and review the significant contracts between the (re)insurer and its affiliates and ensure that agreements are filed with the insurance department in accordance with applicable state requirements. Verify that the (re)insurer is operating in accordance with approved contract terms.
<table>
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<tr>
<th>Identified Risk</th>
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<td></td>
<td>contract execution to ensure that policies are enforced.</td>
<td>provisions.</td>
<td>Consider performing independent testing to evaluate the reasonableness of contract pricing and terms.</td>
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EXAMINATION REPOSITORY – REINSURANCE (CEDING INSURER)

Annual Statement Blank Line Items

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

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

Relevant Statements of Statutory Accounting Principles (SSAPs)

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

No. 5R  Liabilities, Contingencies and Impairments of Assets – Revised
No. 25  Affiliates and Other Related Parties
No. 61R Life, Deposit-Type and Accident and Health Reinsurance – Revised (Health/Life Companies)
No. 62R Property and Casualty Reinsurance – Revised (P&C Companies)
No. 63  Underwriting Pools (Health/Life Companies)
No. 64  Offsetting and Netting of Assets and Liabilities
No. 65  Property and Casualty Contracts (P&C Companies)

Note: Risks within this key activity may warrant additional procedures or consideration at the Head of the Internationally Active Insurance Group (IAIG) or level at which the group manages its aggregated risks. Refer to Section 1, Part I for additional guidance for examinations of IAIGs.
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<tr>
<td><strong>Other Than Financial Reporting Risks</strong></td>
<td></td>
<td>ST</td>
<td>Other</td>
<td>AARP</td>
<td>Review and test the operating effectiveness of the insurer’s processes to identify, track and monitor relevant loss exposures.</td>
<td>Select a sample of directly underwritten policies to verify that the insurer has correctly recorded loss exposure data associated with relevant policies (See also Examination Repository – Underwriting).</td>
</tr>
<tr>
<td>The insurer does not accurately identify, accumulate and track its aggregate loss exposures that may require reinsurance coverage.</td>
<td></td>
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<td></td>
<td>The insurer has a risk management function in place to identify, track and monitor various loss exposures (e.g., catastrophic risk, mortality, morbidity, epidemic, etc.).</td>
<td>Test controls relating to the accuracy of policy data uploaded (by the insurer or a TPA/MGA) to the system (See also Examination Repository – Underwriting).</td>
<td>Analytically review the loss exposure data reported to the company by ceding insurers/brokers on assumed business to identify potential inconsistencies (See also Examination Repository – Reinsurance Assumed).</td>
</tr>
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<td></td>
<td>ST OP</td>
<td>Other</td>
<td>AARP</td>
<td>The (re)insurer has a process in place to review and accumulate loss exposure data reported by its ceding insurer/brokers for inclusion in tracking aggregate loss exposure (See also Examination Repository – Reinsurance Assumed).</td>
<td>Review and test the operating effectiveness of the (re)insurer’s processes to review and accumulate loss exposure data reported by ceding insurers/brokers (See also Examination Repository – Reinsurance Assumed).</td>
<td>If deemed necessary, perform additional procedures to get comfort with the loss exposure data reported to the (re)insurer from ceding insurers/brokers on assumed business (See also Examination Repository – Reinsurance Assumed).</td>
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<tr>
<td>The insurer has not established and</td>
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<td>The insurer has a well-defined reinsurance strategy</td>
<td>Review meeting minutes of the board of directors (or a similar meeting)</td>
<td>Review the insurer’s reinsurance levels for</td>
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<td>Identified Risk</td>
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<td>maintained appropriate reinsurance levels in accordance with the company’s capital level, loss exposures and underwriting risk profile.</td>
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<td>that is based on the aggregate loss exposures it faces. The strategy indicates the type of reinsurance (e.g., aggregate excess of loss, per occurrence, etc.) to be maintained by the organization and is approved by the board of directors (or a committee thereof).</td>
<td>committee thereof) or other evidence of board involvement in the approval of the insurer’s reinsurance policy.</td>
<td>appropriateness. Consider the results of data aggregation/ models to assist in this assessment.</td>
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<td>The insurer has established and documented exposure limits and a risk appetite that have been reviewed and approved by senior management.</td>
<td>Review how aggregated/model loss exposure data is utilized by the company to reach reinsurance decisions.</td>
<td>Review the insurer’s reinsurance coverage as compared to the risk being retained by the insurer to ensure adequate, but not excessive, reinsurance levels.</td>
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<td>The insurer reinsures all exposures that exceed the exposure limits and maintains coverage in accordance with its risk appetite.</td>
<td>Review documentation of reinsurance coverage limits and evidence of senior management review/approval.</td>
<td>Calculate the historical aggregate profitability of reinsurance.</td>
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<td>The insurer has developed formal documentation of its reinsurance structure and has established an effective, ongoing dialogue among the underwriting, claims and reinsurance areas.</td>
<td>Review a summary of all reinsurance contracts to ensure that the coverages match the insurer’s exposure limits.</td>
<td>Consider applying a range of scenarios to a selection of significant reinsurance contracts to test the overall performance/prospective profitability of the contract and to assess whether the ceding commission is greater than the cost to write the business.</td>
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<td>The insurer has a process in place to evaluate the effectiveness of its reinsurance coverage.</td>
<td>Review evidence of interaction between the underwriting, claims and reinsurance areas.</td>
<td>Review reinsurance contracts to determine if risk-limiting provisions (e.g., sliding commissions, loss corridors, etc.) impact the effectiveness of the insurer’s reinsurance strategy.</td>
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<tr>
<td>The insurer’s catastrophic reinsurance protections are inadequate.</td>
<td>ST OP</td>
<td>Other</td>
<td>AARP</td>
<td>The insurer performs a cost/benefit analysis prior to entering into reinsurance agreements.</td>
<td>Review the insurer’s cost/benefit analysis.</td>
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<td>The insurer uses one of the industry’s catastrophic modeling software tools (RMS, AIR, EQECAT, etc.) to determine the probable maximum loss (PML) by zone.</td>
<td>Review the adequacy of the process and tools utilized to determine the insurer’s PML amount(s).</td>
<td>Review the reasonableness of the catastrophic reinsurance coverage in place at the insurer by benchmarking against competitors and/or comparing against industry standards. Consider involving an exam actuary or reinsurance specialist in assessing the adequacy of the insurer’s catastrophic reinsurance coverage.</td>
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<td>The process includes actuarial involvement with the ceded reinsurance department to insure the ceded department purchases the proper amount of reinsurance.</td>
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<td>The insurer adjusts its retentions or uses reinsurance alternatives, such as cat bonds, to ensure full placement at each catastrophic layer.</td>
<td>Determine whether the insurer’s reinsurance strategy requires premium reinstatement for the cat program.</td>
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<td>The insurer has protected itself against multiple occurrences in the same period with contractual reinstatement of coverage.</td>
<td>Review the coverages in place for each layer of reinsurance for appropriate supervisory review.</td>
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<td>Determine whether the insurer’s reinsurance strategy includes the involvement of the actuarial and ceded reinsurance departments in the purchasing of catastrophic reinsurance.</td>
<td></td>
</tr>
<tr>
<td>The insurer is over-exposed to credit and liquidity risks in its use of reinsurance counterparties.</td>
<td>OP ST CR LQ</td>
<td>Other</td>
<td>AARP</td>
<td>The insurer has policies in place requiring utilization of multiple reinsurers to reduce concentration with any one entity.</td>
<td>Test the operating effectiveness of the insurer’s controls to track compliance with the concentration policy.</td>
<td>Based on a review of significant contracts, determine whether the insurer is properly diversified.</td>
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| Smaller, less complex or new insurers are unable to negotiate equitable reinsurance contract terms from larger or more experienced reinsurers. | OP ST LQ | Other | AARP | The insurer has developed a formal process to approve reinsurance counterparties. | Obtain evidence of the company’s process to approve reinsurance counterparties. | Perform procedures to evaluate the quality of significant reinsurers utilized by the insurer; for example:  
  - Review agency ratings  
  - Review financial results  
  Contact domestic regulator regarding any concerns  
  For select reinsurers, verify that the balance currently ceded is within the maximum limits set by the insurer. |
<p>| | | | | The insurer has a process in place to preapprove and set maximum limits to be ceded to reinsurers that are monitored and revised, as necessary. | Obtain evidence of the preapproval process and documentation of maximum reinsurance limits. |
| | | | | The insurer continually monitors the financial solvency of its reinsurers throughout the duration of the reinsurance contracts. | Obtain evidence of the insurer’s ongoing review of its reinsurers. |
| | | | | Collateral is held in association with significant treaties to encourage prompt settlement and fulfillment of obligations. | Obtain evidence of the insurer’s process to consider/require collateral to be held for significant treaties. |
| Financial Reporting Risks | | | | The insurer has policies and procedures in place to ensure all contracts with affiliates are filed with the insurance department as required by applicable state statutes (Form D filing). | Review the insurer’s policies and procedures in place to ensure such policies adhere to applicable statutes and would adequately identify transactions requiring a filing. |
| Reinsurance contracts with affiliates have not been filed in accordance with applicable state statutes and do not include equitable | OP ST | CM AC | AARP RPHCC | Review the work performed by the insurer to determine whether the intermediary is licensed. | Review the credentials, background and experience of those negotiating the contracts to ensure that they are licensed to represent the insurer in contract negotiations. |</p>
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| contract provisions. |              |            |               | The insurer has policies in place to ensure that all contracts with affiliates are negotiated at arm’s length and are in accordance with statutory accounting principles (SAP). These policies ensure that:  
- Contracts are subject to review and approval by senior management;  
- Ceding commissions are sufficient to cover the insurer’s underwriting expenses.  
- Contract terms comply with SSAP No.25;  
- Reinsurance is not being used to transfer capital to affiliates; and  
- Actuarial review is performed prior to contract execution to ensure that policies are enforced.  
  
The insurer has policies in place to ensure multiple cedent contracts have fair and equitable allocation terms and are subject to review and approval by all impacted divisions (e.g., accounting, actuarial, etc.).  
  | Test the insurer’s process to ensure that transactions with related parties are negotiated at arm’s length by obtaining evidence of senior management review and approval and support for the sufficiency of ceding commissions, risk transfer and adequate pricing.  
  | state requirements. Verify that the insurer is operating in accordance with approved contract terms.  
  | Review contract provisions for reasonableness through conducting analytical procedures such as comparing ceding commissions to the insurer’s expense ratio or comparing actual to expected results.  
  | Consider involving a reinsurance expert or actuarial examiner to review complex contracts and/or those with questionable provisions.  
  | Consider performing independent testing to evaluate the reasonableness of contract pricing and terms.  
  | Review significant multiple cedent agreements to ensure allocation terms and agreements are clearly documented and equitable.  
| Reinsurance contracts are not completed and accounted for in | OP | PD | RRC | The insurer evaluates all reinsurance contracts to ensure that there is adequate evidence of insurer evaluation and review for state requirements.  
<p>| Examine contracts for evidence of insurer evaluation and review for | Obtain copies of all significant reinsurance contracts in-force and |</p>
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<tr>
<td>compliance with SAP and applicable state requirements.</td>
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<td>transfer of risk, in compliance with SAP.</td>
<td>all required regulatory elements.</td>
<td>complete Exhibit N, Part Three, to ensure transfer of risk.</td>
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<td>Contracts are reviewed to ensure inclusion of adequate collateral and contract provisions as required by SAP.</td>
<td>• For P&amp;C insurers, review the insurer’s policies and procedures in place to 1) determine how the reinsurance agreement is accounted for (prospective, retroactively or deposited in accordance with SSAP No. 62R); and 2) ensure the agreement includes required agreement terms.</td>
<td>If a contract does not transfer risk, verify whether it has received deposit accounting treatment in accordance with SAP.</td>
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<td>All reinsurance contracts are reviewed by the insurer’s legal department to ensure that there are no provisions that might adversely affect the insurer.</td>
<td>• For life insurers, review the insurer’s policies and procedures in place to ensure compliance with Appendix A-791.</td>
<td>Obtain copies of all significant reinsurance contracts in-force for the period under examination. Determine whether the contract includes effective date and execution date, payment terms, termination clause, insolvency clause, policies/lines of business reinsured, insurer retention, etc.</td>
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<td>The insurer has policies in place to ensure that reinsurance contracts are finalized, reduced to written form and signed in accordance with applicable SSAPs.</td>
<td>• For P&amp;C insurers, contracts must be executed within nine months of effective date or accounted for as retroactive agreements in accordance with SSAP No. 62R.</td>
<td>For a sample of P&amp;C reinsurance contracts, determine whether the effective date and the execution date fall within nine months of each other or that the contract is accounted for retroactively in accordance with SSAP No. 62R.*</td>
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<td>• For life insurers, credit for reinsurance is not authorized if the agreement, amendment or binding letter of intent is not executed by both parties by the “as-of” date of the financial statement in</td>
<td>For a sample of life reinsurance contracts, determine whether the effective date and execution date meet Appendix A-791 requirements.*</td>
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<td>The insurer is not accurately billing and recording loss and loss adjustment expense (LAE) payments for policies linked to reinsurance contracts.</td>
<td>OP</td>
<td>EX</td>
<td>RRC</td>
<td>The insurer has procedures in place whereby policies meeting reinsurance contract criteria are automatically attached to the applicable reinsurance contract. When a claim is filed on a tagged policy, the system notifies the user so that the claim can be subjected to the reinsurance process. When claims are paid that are covered under a reinsurance policy, a billing is automatically generated with all of the relevant claim information required by the reinsurer and a corresponding recoverable amount is recorded. The insurer has procedures in place whereby timely notice is provided to the reinsurer in accordance with reporting requirements (e.g., reported claims in excess of 50% of retention, death or dismemberment). Records associated with reinsurance recoverable balances are appropriately restricted, conform to standards outlined in the reinsurance treaty and.</td>
<td>Test the operating effectiveness of the identification and billing of reinsurance recoverable balances through reperformance and observation. Test the operating effectiveness of controls over the reinsurance recordkeeping process by observing access restrictions and inspecting documents.</td>
<td>Perform procedures to test whether the level of ceded recoverables are reasonably equivalent to the level of assumed liabilities reported by the assuming reinsurers. Verify whether the ceding insurer has paid the claims associated with the recoverable balance by vouching to copies of the claim payments. In conjunction with testing performed in the Examination Repository – Reserves/Claims Handling, test a sample claims (including those handled by a TPA/MGA) to determine whether claims subject to reinsurance were appropriately identified.</td>
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<td>Significant reinsurance recoverables are overstated or not collectible.</td>
<td>CR</td>
<td>EX VA</td>
<td>RRC</td>
<td>The insurer continually monitors the financial solvency of its reinsurers throughout the duration of the reinsurance contracts.</td>
<td>Review assessments of the reinsurance review performed by internal/external auditors, reinsurers and/or others for significant issues.</td>
<td>Perform procedures to test whether the level of ceded recoverables are reasonably equivalent to the level of assumed liabilities reported by the assuming reinsurers. Obtain and analyze recent financial information of the assuming (re)insurer (e.g., annual financial statement, SEC filings, etc.) or results of insurance industry reporting and rating services (e.g., A.M. Best, S&amp;P, FAST tools, etc.) to determine the credit worthiness of significant reinsurers. Perform procedures to determine the collectability/existence of reinsurance recoverable balances:</td>
</tr>
</tbody>
</table>

provide adequate supporting evidence for the net recoverable balances.

If this process is outsourced to a third-party administrator (TPA) or managing general agent (MGA), the insurer has a process in place to monitor the activities of the TPA/MGA (e.g., obtains or performs regular audits, obtains SOC 1 report, requires periodic reporting, etc.).

demonstrating supervisory review of reinsurance recordkeeping.

Review audit reports and other documentation to determine whether the insurer provides sufficient oversight of its TPAs/MGAs.

Review assessments of the reinsurance review performed by internal/external auditors, reinsurers and/or others for significant issues.

Obtain documented review of aging reports and support for the collectability of any delinquent uncollected amounts.
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<tr>
<td>Funds held as security for XXX/AXXX transactions are not adequate to support the reserve.</td>
<td>CR</td>
<td>VA</td>
<td>AARP</td>
<td>The insurer periodically reviews the underlying security for XXX/AXXX transactions for compliance with applicable state investment laws for the ceding insurer and SSAPs. For transactions subject to AG 48, the insurer’s appointed actuary conducts</td>
<td>Verify that a review of the underlying security for XXX/AXXX transactions is conducted on a periodic basis and subject to management review and approval. Obtain the analysis prepared by the insurer’s appointed actuary and verify</td>
<td>Review the investment portfolio of the ceding insurer to determine compliance with applicable state investment laws for the ceding insurer and SSAPs. For a sample of reinsurance policies not subject to AG 48, review the funds</td>
</tr>
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<tr>
<td>The insurer is not properly calculating the provision for reinsurance. (&lt;i&gt;P&amp;C Companies&lt;/i&gt;)</td>
<td>OP</td>
<td>AC VA EX CM PD</td>
<td>RRC</td>
<td>An analysis of XXX/AXXX reinsurance arrangements on a treaty-by-treaty basis to determine that funds consisting of Primary Security and Other Security are appropriately held by or on behalf of the ceding insurer or that the insurer has established a liability in accordance with AG 48.</td>
<td>Management review and approval.</td>
<td>Held by or on behalf of the ceding insurer as security for the reinsurance transaction to determine compliance with applicable state investment laws for the ceding insurer and SSAPs. Consider requesting an asset/liability matching run on a standalone basis for all business issued through a reinsurance financing agreement. For a sample of reinsurance transactions subject to AG 48, review the assets held by or on behalf of the ceding insurer that constitute the Required Level of Primary Security to determine whether the requirements for classification of “Primary Security” per AG 48 have been met.</td>
</tr>
</tbody>
</table>

The insurer has policies in place to determine whether reinsurers are authorized, unauthorized or certified. A provision for reinsurance is completed for unauthorized and certified reinsurers in accordance with SAP. The insurer maintains and verifies adequacy of funds held, letters of credit, trust account balances or any other forms of collateral. Obtain documentation relating to authorized, unauthorized and certified reinsurers. Review company support for reinsurer status and evidence of provision calculation and review. Obtain evidence of insurer verification of funds held, letters of credit, trust account balances or any other forms of collateral. Verify authorization and certified reinsurer status for reinsurers included in the provision for reinsurance calculations. Review the letters of credit to verify whether they are clean, irrevocable and issued by a qualified U.S. financial institution, as defined in Appendix A-785 of the <i>Accounting Practices and Procedures Manual</i>. |
<table>
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<tr>
<th>Identified Risk</th>
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<th>Exam Asrt.</th>
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<td>The insurer has controls in place to reconcile the recoverable balances, agings, amounts in dispute and offset payable balances used in the provision calculation to those amounts reported in the general ledger and accounting system. The provision for reinsurance calculation is reviewed by management to ensure accuracy.</td>
<td>Obtain and review the completed reconciliations. Test any significant reconciling items for appropriateness.</td>
<td>Verify the existence and adequacy of funds held, trust account balances or any other forms of collateral. Verify whether the trustee is a qualified U.S. financial institution and that the form of the trust and amounts comply with the laws and regulations of the state of the ceding insurer’s commissioner. Identify any significant amounts included in the calculation not previously examined. Perform procedures to ascertain the validity of the amounts and their utilization in the calculation. Recalculate the provision for reinsurance.</td>
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<tr>
<td>Insurer is taking credit for reinsurance contracts with unauthorized reinsurers. (Non-P&amp;C Companies)</td>
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<td>The insurer has processes in place to segregate authorized, unauthorized and certified reinsurer contracts in accordance with the requirements set forth in Appendix A-785 – Credit for Reinsurance. The insurer includes appropriate collateral requirement provisions in all contracts with unauthorized and certified reinsurers.</td>
<td>Perform a walkthrough to gain an understanding of the insurer’s process to segregate authorized, unauthorized and certified reinsurer contracts. Obtain contracts to determine whether provision for collateral requirement is included and adequate.</td>
<td>Perform procedures to verify that reserve credits are taken appropriately under the requirements of Appendix A-785 of the Accounting Practices and Procedures Manual or applicable state laws and regulations. For example, verify the amount and validity of collateral held in support of credits taken.</td>
</tr>
<tr>
<td>Identified Risk</td>
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<tr>
<td>The insurer is overestimating the reinsurance credit on incurred but not</td>
<td>OP</td>
<td>VA AC</td>
<td>RRC</td>
<td>The insurer estimates reinsurance credit on IBNR loss and IBNR LAE reserves by</td>
<td>Test the operating effectiveness of the insurer’s process to calculate reinsurance credits</td>
<td>Consider the reasonableness of reinsurance credits taken, based on a review of the</td>
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<tr>
<td>reported (IBNR) loss and IBNR LAE reserves.</td>
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<td>reviewing reinsurance treaties in place at the insurer, as well as historical results.</td>
<td>on IBNR loss and IBNR LAE reserves, including involvement of the appointed actuary,</td>
<td>insurer’s reinsurance program and treaties in place.</td>
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<td>(See also Examination Repository – Reserves/Claims Handling)</td>
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<td></td>
<td>The insurer’s appointed actuary is involved in calculating and/or estimating/reviewing the credit amount.</td>
<td>management approval and sign-off.</td>
<td>Utilize the insurance department actuary or an independent actuary to review the</td>
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<td>reasonableness of ceded reinsurance estimates included in the opining actuary’s report.</td>
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<td>Compare the credit amounts recorded by the insurer to reinsurers’ estimated liability, if available.</td>
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<td>Recalculate or test actual credits taken on a sample of contracts and verify whether the ceding insurer is correctly applying the terms.</td>
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Annual Statement Blank Line Items

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

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

Relevant Statements of Statutory Accounting Principles (SSAPs)

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

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

Note: Risks within this key activity may warrant additional procedures or consideration at the Head of the Internationally Active Insurance Group (IAIG) or level at which the group manages its aggregated risks. Refer to Section 1, Part I for additional guidance for examinations of IAIGs.
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<tr>
<td><strong>Other Than Financial Reporting Risks</strong></td>
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<tr>
<td>The board of directors (or committee thereof) is not involved in establishing and/or reviewing the insurer’s overall reserving practices.</td>
<td>OP ST RV</td>
<td>Other RA</td>
<td></td>
<td>The insurer’s board of directors (or committee thereof) has adopted and/or reviewed the insurer’s overall reserving practices.</td>
<td>Verify that the insurer has established overall reserving practices that have been adopted and/or reviewed by the board of directors (or committee thereof).</td>
<td>Obtain information on the insurer’s overall reserving practices, including meeting materials, and forward it to the insurance department actuary or an independent actuary for review.</td>
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<td>The board of directors (or committee thereof) regularly discusses reserving issues and receives reports from the appointed actuary. The reports include an explanation of the reserving policy and methodology, as well as an analytical review of the insurer’s reserves.</td>
<td>Review board of directors (or committee thereof) minutes to ensure discussion of reserving. Review meeting materials to determine if materials would properly facilitate BOD oversight.</td>
<td>Discuss with members of the board of directors (or committee thereof) their level of involvement in the monitoring of reserving practices.</td>
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<td>The insurer monitors and revises its reserving practices as needed.</td>
<td>Obtain information on revisions made by the insurer to its reserving practices and verify whether they were appropriately reviewed and/or approved by the board of directors (or committee thereof).</td>
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<tr>
<td><strong>Financial Reporting Risks</strong></td>
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</table>
| New claims are not entered into the claims management system; i.e., claims population is not complete. | RP LG AC CT CO RD |            |                | Segregation of duties exists between the claim notification and the input of claims data into the claims system. Control reports exist to ensure all claims reported to the insurer electronically or manually have been entered into the claims system.                                                                                                                                                                       | Observe that segregation of duties exists between the claim notification and the input of claims data into the claims system. Obtain the exception report and ensure management reviews the report and resolution of any exceptions. Select a sample of items from the exception reports and verify that the claim was appropriately accounted for.* | Select a sample of claim and expense payments made subsequent to year-end to verify that claims were recorded in the proper...
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<tbody>
<tr>
<td>Claims data (e.g., claim attributes) in the claims database is inaccurate or incomplete.</td>
<td>OP LG AC CT CO EX RD</td>
<td>Claims data is subject to independent verification or quality assurance (QA) reviews.</td>
<td>The insurer reviews the Type II SOC 1 reports and ensures compliance with user-control considerations for any outsourcing companies that enter claims on behalf of the insurer.</td>
<td>Test the operating effectiveness of the automated claims posting process through reperformance and observation, which could include IT testing of batch totals to ensure completeness of transactions processed. Obtain documentation of management’s review of the Type II SOC 1 reports.</td>
<td>Perform data validation tests to verify the accuracy of claim information maintained in the claims system, such as coverage terms, demographic data, date of service, provider name, service description or code, insured name, claim number, paid claim date, paid claim amount, and coverage period by vouching the information to the claimant’s insurance contract, claims form and any other underlying support. Utilize an actuary to determine the most significant lines of business and data points used in the estimate, and focus accuracy testing on those *</td>
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<tr>
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</table>
| The third-party administrators (TPAs), or managing general agents (MGAs), are not processing claims in accordance with the insurer’s claims | LG OP RP | AC CM RD | | populate select policy data. System edits will identify data that does not meet the predetermined criteria, such as an invalid social security format or missing provider name, resulting in inclusion on a system-generated exception report. Segregation of duties exists between individuals responsible for new claim set-up and those responsible for setting up new policies. | reperformance and observation. | Scan the database(s) for internal inconsistencies, such as missing claim amounts, unusually small amounts and claims misclassified by type (e.g., Medicare). In situations where adequate segregation of duties is not apparent, obtain data to determine whether any claims were set up by the same user who created the corresponding policy in the master file. If any instances are identified, investigate the claim to ensure the claim exists and is supported by underlying data. Perform analytical procedures over the population of claims data—i.e., paid claims—at the appropriate disaggregation level to identify any unusual trends or anomalies pertaining to the accuracy of claims data that should be further investigated. |}

*The insurer performs regular audits of its TPAs/MGAs to determine whether insurer claims handling standards and additional contract provisions are being consistently followed by the insurer.*
<table>
<thead>
<tr>
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<tr>
<td>procedures as outlined in the TPA agreement.</td>
<td></td>
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<td></td>
<td>TPA.</td>
<td>Verify that the insurer has obtained and reviewed the TPA’s Type II SOC 1 report, if available.</td>
<td>Review the Type II SOC 1 report to determine whether the controls outlined in the report are adequate to ensure that claims are being processed in accordance with the TPA agreement. Test for compliance with applicable state MGA regulations.</td>
</tr>
</tbody>
</table>
| Claims are not being processed accurately and in accordance with insurer guidelines. | OP ST       | AC CM     | RD             | The insurer has administrative policies and maintains a claims procedures manual that outlines the following requirements:  
- Maximum benefit to be paid based on procedure type.  
- Usual, customary and reasonable (UCR) limitations.  
- Proper application of deductibles.  
- Reserving and payment authority and approval levels.  
- File documentation and tracking.  
- Procedures for handling suspicious and/or fraudulent claims.  
- Compliance with applicable state fair claims practices laws | Review the claims procedures manual to determine its appropriateness, including management approval. | Perform tests to determine whether claims were accurately processed in accordance with the claims procedures manual, approved authority limits and administrative policies through review of the claimant’s insurance contract, claims form and any other underlying support. Review policyholder complaints and investigate significant issues. Review a sample of denied claims to ensure compliance with contract provisions.* |
<table>
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<tr>
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<tr>
<td>and/or regulations. Automated controls are in place to ensure that paid losses are not to exceed policy limits, cover ineligible loss causes/types and/or apply to a policy period for which insurer is not contractually responsible. Any consideration to pay a loss must be processed in accordance with the insurer’s procedures. As part of the claims processing procedures, the insurer obtains adequate documentation and coverage of benefits before a claim is settled. Claims approval is subject to approved authority limits. A QA review is periodically performed for each claims processor to ensure compliance with the claims handling policies.</td>
<td>Test the operating effectiveness of system edit checks to ensure procedures are implemented through reperformance and observation. Review assessments of the claims handling process performed by internal/external auditors, reinsurers and/or others for significant issues. Test the operating effectiveness of controls to ensure adequate documentation is obtained before payment is made. Review documentation of QA reviews to determine that the QA function is being executed as outlined in the insurer’s policies. On a sample basis, reperform the QA testing to ensure that the testing was completed accurately.</td>
<td>Review the insurer’s reconciliation reports of Test any reconciling items within the reconciliations</td>
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<thead>
<tr>
<th>The claims data utilized by the actuary</th>
<th>OP RV</th>
<th>AC CO</th>
<th>RD</th>
<th>The insurer has established procedures to reconcile</th>
<th>Review the insurer’s reconciliation reports of</th>
<th>Test any reconciling items within the reconciliations</th>
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Attachment A
<table>
<thead>
<tr>
<th>Identified Risk</th>
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<tr>
<td>to estimate reserves does not correspond to the data in the insurer’s claims system and to the data in the insurer’s accounting records.</td>
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<td>actuarial data and claims triangles to the insurer’s claims system, the data in the insurer’s accounting records and appropriate annual financial statement schedules and/or exhibits (three-way match). Such reconciliations are reviewed by supervisory personnel. Inventories of reported and unpaid claims are maintained and periodically reconciled to the general ledger.</td>
<td>actuarial data and claims triangles to the insurer’s claims system and the insurer’s accounting records. Ensure evidence of supervisory review. Review the insurer’s reconciliation of reported and unpaid claims to the general ledger.</td>
<td>for appropriateness. Reconcile the insurer’s actuarial report for claims paid and claims adjustment expenses (CAE) to supporting insurer reports (trace into claim lags), general ledger and annual financial statement schedules and exhibits as of the valuation date. Vouch payment of claim into bank statement. Test completeness of the data by gap testing sequences of checks and investigating any gaps, as well as utilizing bank reconciliations and testing any outstanding checks. Perform analytical procedures to review the reasonableness of paid claims.</td>
</tr>
<tr>
<td>Reinsurance is not properly taken into account in accumulating claims data.</td>
<td>RV</td>
<td>AC CO RD RRC</td>
<td></td>
<td>The insurer has established procedures to prepare the claims data for actuarial review in accordance with the insurer’s reinsurance treaties.</td>
<td>Review the insurer’s reconciliation reports of actuarial data to the insurer’s claims system, reinsurance reports, and accounting records. Test the operating effectiveness of the insurer’s established procedures to include claims data from assumed reinsurance treaties within</td>
<td>Test reconciling items relating to reinsurance claims data for appropriateness. Verify assumed reinsurance claims data accumulated for actuarial review by comparing to the data provided by the ceding insurer for completeness.</td>
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<tr>
<td>Identified Risk</td>
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<tr>
<td>Initial claim reserves are not established or reviewed in accordance with insurer standards.</td>
<td>RV CR</td>
<td>AC VA CO</td>
<td>RA</td>
<td>The insurer has a claim reserving philosophy and qualified actuaries are involved in establishing and reviewing the reserving policy.</td>
<td>Obtain documentation supporting the insurer’s reserving philosophy. Review reserving philosophy for actuary review and policy adequacy.</td>
<td>For a sample of reserves verify that the calculation is in accordance with the reserving philosophy and that reserves are calculated on a timely basis.*</td>
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<td>Initial reserves are made in accordance with the insurer’s reserving philosophy and within a specified time frame.</td>
<td>For a sample of loss reserves, determine whether loss reserve reviews were performed and documented in accordance with insurer policy.</td>
<td>For a sample of reserves meeting the criteria to go to a claims committee, determine whether the reserves were referred to this committee.*</td>
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<td>Claim adjusters/supervisors are required to review significant initial case reserves on a timely basis and make adjustments as necessary.</td>
<td>Obtain periodic new claims reports and verify the insurer reviews significant initial case reserves and makes adjustments, if necessary, in a timely manner.</td>
<td>Confirm a sample of unpaid claims with major providers.</td>
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<td>Committees are formed to evaluate and strategize claims involving serious injuries, complex claims law, and large or unusual loss reserve determinations or settlements.</td>
<td>Obtain minutes and other meeting materials from the meetings of the committee to determine whether the committee provided appropriate oversight.</td>
<td></td>
</tr>
<tr>
<td>Claim reserves (other than IBNR) are not updated accurately.</td>
<td>RV CR</td>
<td>CO VA</td>
<td>RA</td>
<td>The insurer has a policy requiring open claims to be reviewed regularly. When new information is received, case reserves are reviewed and adjusted, if necessary.</td>
<td>From a sample of claim reserves (other than IBNR), determine whether the reserves are updated regularly and are appropriately updated when new information is received.</td>
<td>Select a sample of paid claims and compare the final overall claims settlement with the case reserve to determine whether the reserves are adequate and/or updated accurately.</td>
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* For a paid claim, verify that the calculated reserves were based on the insurer’s reserving philosophy when made.
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<tr>
<td>of reserve increases and decreases, an outstanding reserve list, an outstanding reserve list by claim adjuster, and a reserve release report. These reports are reviewed/monitored by the claims manager for reasonableness.</td>
<td>RV</td>
<td>VA AC PD</td>
<td>RA</td>
<td>reports, noting management approval.</td>
<td>Perform analytical procedures to determine whether the actual reserves were adequate and appropriately updated based upon the amount paid.</td>
<td>Verify that the information contained in the reports is accurate and determine whether the appropriate analyses are being used to evaluate the reserves.</td>
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<tr>
<td>Gain an understanding of the insurer’s assumptions and methodologies and compare with prior periods.</td>
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<td>Verify that senior management signs off on assumptions and methodologies used by the insurer, including any changes.</td>
<td>Review assumptions and methodologies for reasonableness, appropriateness and accuracy, with assistance from the insurance department actuary or an independent actuary. Verify that reservation assumptions are in accordance with the relevant SSAPs related to health reserving, as well as any applicable state statutes, regulations, actuarial guidelines, pronouncements and/or bulletins.</td>
<td>Review prior history of claims development, as well as subsequent claims development data to analyze the reasonableness of assumptions and methodologies, and identify any management judgments/assumptions.</td>
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<tr>
<td>Actuarial analysis is subject to a peer review process.</td>
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<td>Verify senior management review of reports from actuaries and that reports include reserve analyses of all major lines of business.</td>
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<tr>
<td>Review assumptions and methodologies for reasonableness, appropriateness and accuracy, with assistance from the insurance department actuary or an independent actuary.</td>
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<td>Verify that reserving assumptions are in accordance with the relevant SSAPs related to health reserving, as well as any applicable state statutes, regulations, actuarial guidelines, pronouncements and/or bulletins.</td>
<td>Review prior history of claims development, as well as subsequent claims development data to analyze the reasonableness of assumptions and methodologies, and identify any management judgments/assumptions.</td>
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</tr>
<tr>
<td>The assumptions and methodologies used by the insurer for the health, long-term care and long-term disability business are not accurate and appropriate.</td>
<td>RV</td>
<td>VA AC PD</td>
<td>RA</td>
<td>The insurer uses consistent assumptions and methodologies that have been based on historical results (to the extent appropriate), adequately documented, approved by senior management and in accordance with statutory accounting principles (SAPs), Actuarial Standards of Practice (ASOPs), and applicable state statutes and/or regulations.</td>
<td>Senior management uses either internal or independent actuaries to conduct reserve analyses of all major lines of business on an annual basis. Actuarial analysis is subject to a peer review process.</td>
<td>Review assumptions and methodologies for reasonableness, appropriateness and accuracy, with assistance from the insurance department actuary or an independent actuary. Verify that reservation assumptions are in accordance with the relevant SSAPs related to health reserving, as well as any applicable state statutes, regulations, actuarial guidelines, pronouncements and/or bulletins.</td>
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Review prior history of claims development, as well as subsequent claims development data to analyze the reasonableness of assumptions and methodologies, and identify any management judgments/assumptions.
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<tr>
<td>Management receives regular reports on loss ratios by line or class of business, as well as other key ratios and operational reports (e.g., claim count, per member per month ratio, etc.), and reviews unusual fluctuations on a timely basis to review reserves for adequacy.</td>
<td>the operating effectiveness of procedures in place.</td>
<td>related to estimates that indicate possible bias.</td>
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<tr>
<td>The insurer utilizes a fully staffed, well-qualified actuarial department that is under the direction of a fellow of the Society of Actuaries (FSA) or member of the American Academy of Actuaries (MAAA) and is experienced in the lines of business written by the insurer.</td>
<td>Review the credentials, background and responsibilities of the insurer’s actuarial department (internal or external) for appropriateness.</td>
<td>Determine whether the appropriate disclosures have been made in the Notes to the Financial Statements for the changes in reserve methodologies.</td>
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<tr>
<td>The reserving actuarial unit’s responsibilities are segregated from the pricing actuarial unit, but there is regular communication between the two units.</td>
<td>Request and review the insurer’s organizational chart and job descriptions to determine whether the functions are separate and distinct.</td>
<td>Review actuarial reports and compare reports to prior periods. Investigate significant variations.</td>
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<tr>
<td>The insurer’s organizational structure limits the influence that management can have on the appointed actuary.</td>
<td>Interview the appointed actuary during the planning phase of the examination to determine whether the insurer’s organizational structure is appropriate in this area.</td>
<td>Utilize the insurance department actuary or an independent actuary to perform an independent calculation/estimate of the reserves.</td>
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<tr>
<td>The insurer has</td>
<td>Review insurer processes in place to calculate the reserve calculations to ensure consideration is given to policy lapse rates.</td>
<td>Review correspondence related to peer review for appropriate depth of review.</td>
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<th>Identified Risk</th>
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<th>Possible Test of Controls</th>
<th>Possible Detail Tests</th>
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</thead>
<tbody>
<tr>
<td>The claims unpaid, claims reserve, policy reserve and premium deficiency reserve computations are not performed correctly or the selected estimates are unreasonable.</td>
<td>OP RV</td>
<td>AC VA</td>
<td>RA</td>
<td><strong>appropriately established procedures to include policy lapse rates when calculating the reserving estimates.</strong></td>
<td><strong>Review the process in place (which may include performance of a walkthrough) to estimate the claims unpaid, claim reserves, policy reserves and premium deficiency reserves.</strong></td>
<td><strong>Utilize the insurance department actuary or an independent actuary to perform an independent estimate of the claims unpaid, claims reserve, policy reserve and premium deficiency reserves.</strong> Perform analytical procedures to review the reasonableness of reserve estimates.</td>
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<tr>
<td>The insurer has an established process (although assumptions and methodologies may change) to estimate the claims unpaid, claim reserves, policy reserves and premium deficiency reserves on an annual basis.</td>
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<td><strong>The insurer maintains a fully staffed, well-qualified actuarial department that is under the direction of a fellow of the Society of Actuaries (FSA) or member of the American Academy of Actuaries (MAAA) and is experienced in the lines of business written by the insurer.</strong></td>
<td><strong>Review the credentials, background and responsibilities of the insurer’s actuarial department staff for appropriateness.</strong></td>
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<tr>
<td>Senior management uses either internal or independent actuaries to conduct reserve analyses of all major lines on an annual basis.</td>
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<td><strong>The actuarial calculations are subject to a peer review process.</strong></td>
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<td>The actuarial calculations are subject to a peer review process.</td>
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<tr>
<td>The claims adjustment expense (CAE) computations are not performed correctly.</td>
<td>OP RV</td>
<td>AC VA CO</td>
<td>RA</td>
<td>The insurer’s board of directors (or committee thereof) receives an annual presentation on the actuarial analysis process. Management receives regular reports on claims ratios (including claims unpaid, claims reserve, policy reserve and premium deficiency reserve) by line or class of business for accident year and calendar year, as well as other key ratios, and reviews unusual fluctuations on a timely basis to review reserves for adequacy.</td>
<td>Review the board of directors (or committee thereof) minutes to verify that a presentation was given on the actuarial analysis process. Verify management review of reserve reporting and test the operating effectiveness of procedures in place.</td>
<td>Utilize the insurance department actuary or an independent actuary to perform an independent calculation/estimate of the CAE. Perform analytical procedures to review the reasonableness of CAE calculations.</td>
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<td>The insurer has established processes to estimate both the cost containment and other claim adjustment reserves on an annual basis. The insurer maintains a fully staffed, well-qualified actuarial department that is under the direction of a fellow of the Society of Actuaries (FSA) or member of the American Academy of Actuaries (MAAA) and is experienced in the lines of business written by the insurer.</td>
<td>Review the processes (which could include a walkthrough) in place to calculate both the cost containment and other claim adjustment reserves. Review the credentials, background and responsibilities of the insurer’s actuarial department staff for appropriateness. Obtain actuarial reports to verify the insurer is using either independent or in-house actuaries to perform separate cost containment and other claim adjustment</td>
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<td>Senior management uses either internal or independent actuaries to conduct separate cost containment and other claim adjustment reserve analysis of all major lines on an annual basis.</td>
<td>reserve analyses on an annual basis. Verify senior management review of reports from actuaries.</td>
<td>If the analyses are performed in-house, review and test the actuarial peer review process and related sign-offs. Review the board of directors’, (or committee thereof) meeting minutes to verify whether a presentation was given on the actuarial analysis process. Verify management review of reserve reporting and test the operating effectiveness of procedures in place.</td>
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<td>The actuarial analyses are subject to a peer review process.</td>
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<td></td>
<td>The insurer’s board of directors (or committee thereof) receives an annual presentation on the actuarial analysis process.</td>
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<td></td>
<td>Management receives regular reports on loss ratios by line or class of business, as well as other key ratios, and reviews unusual fluctuations on a timely basis to review reserves for adequacy.</td>
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<tr>
<td>Changes in the legal environment or changes in the insurer’s underwriting, reserving or claims</td>
<td>OP RV ST</td>
<td>VA PD AC</td>
<td>RA</td>
<td>The insurer has procedures in place for its legal department to monitor and communicate changes in the legal environment (e.g., changes in case law, award</td>
<td>Review the insurer’s process to monitor changes in the legal environment that may affect the reserving process.</td>
<td>Through a review of the actuarial reports, determine whether changes in the legal environment and/or changes in the insurer’s internal processes have been</td>
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<td>handling processes are not appropriately considered within the insurer’s reserving assumptions and methodologies.</td>
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<td>amounts, trends in the number of claims being litigated) are being taken into consideration by the reserving unit in a timely manner.</td>
<td>Review evidence of communication between the reserving unit and other relevant insurer units.</td>
<td>properly incorporated in the insurer’s reserving assumptions and methodologies.</td>
</tr>
<tr>
<td>The computations of reinsurance credits within the reserves are not performed correctly. (See also Examination Repository – Reinsurance Ceding Insurer)</td>
<td>CR RV</td>
<td>AC VA CO</td>
<td>RA RRC</td>
<td>The reserving actuary calculates the reserve on a gross basis and determines the net basis by estimating the reinsurance credits and applying them to the gross reserve.</td>
<td>Test the operating effectiveness of the insurer’s process for reviewing the reserve analysis to determine whether reserves have been estimated on a gross basis, including management approval and sign-off.</td>
<td>Compare the annual financial statement net and gross incurred and paid loss presentation for consistency with reinsurance treaties in place at the insurer.</td>
</tr>
<tr>
<td></td>
<td>The insurer applies reinsurance credits to reserves by reviewing reinsurance treaties in place at the insurer, as well as historical results.</td>
<td>Test the operating effectiveness of the insurer’s process to estimate reinsurance credits for reserves, including management approval and sign-off.</td>
<td>Consider the reasonableness of reinsurance credits taken, based on a review of the insurer’s reinsurance program and treaties in place.</td>
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<tr>
<td>The insurer is not properly recording case reserves (assumed or ceded) for contracts subject to reinsurance.</td>
<td>RV CR LG</td>
<td>CO VA AC</td>
<td>RA RRC</td>
<td>The insurer has policies in place to verify that case reserves subject to reinsurance are valid and accurate (within contract time frame, covered under the contract, etc.).</td>
<td>Review insurer policies to determine appropriateness, noting management approval.</td>
<td>Utilize the NAIC Examination Jumpstart report to determine whether case reserves recorded by the insurer agree with the case reserves of the assuming (ceding) insurer.</td>
</tr>
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<tr>
<td>Management books reserves that are materially different than the actuary’s best estimate.</td>
<td>OP ST LG</td>
<td>VA PD</td>
<td>RA</td>
<td>The insurer has a process in place to ensure that reserves are recorded based on the actuary’s best estimate, or documents an appropriate reason for any deviations.</td>
<td>Review management guidelines regarding the recording of actuarially determined reserves. Verify that deviations from the actuary’s best estimate are properly documented, if applicable.</td>
<td>Review the actuarial report, as well as the annual financial statements and other appropriate documentation, to determine whether the insurer has booked the actuary’s best estimate. Review the documentation supporting a deviation from the actuary’s best estimate for reasonableness, if applicable.</td>
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<td></td>
<td>The board of directors (or committee thereof) reviews management’s best estimate of booked reserves and challenges such estimates based on reports received, including the actuarial report from the appointed actuary.</td>
<td>Review the board of directors (or committee thereof) meeting minutes for evidence of a presentation and review of information supporting management’s best estimate of the booked reserves (i.e., the actuarial report).</td>
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<td>The insurer’s organizational structure limits the influence that management can have on the appointed actuary.</td>
<td>Interview the appointed actuary during the planning phase of the examination to determine whether the insurer’s organizational structure is appropriate in this area.</td>
<td></td>
</tr>
<tr>
<td>The insurer does not maintain an adequate premium deficiency reserve.</td>
<td>RV LQ OP</td>
<td>VA CO CM</td>
<td>RA</td>
<td>The insurer has a process in place to review for premium deficiencies on an annual basis in accordance with SSAP No. 54.</td>
<td>Review the process in place and verify key controls surrounding the calculation of premium deficiency reserves.</td>
<td>Perform an analytical review of loss ratios. If necessary, utilize the insurance department actuary or an independent actuary to perform a detailed review or an independent calculation/estimate of the premium deficiency reserves.</td>
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<td></td>
<td>Independent actuaries review and sign off on premium deficiency reserve calculations.</td>
<td>Obtain the actuarial opinion and verify approval of premium deficiency reserve calculations.</td>
<td></td>
</tr>
</tbody>
</table>
Annual Statement Blank Line Items

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

Aggregate Reserve for Life Contracts
Aggregate Reserve for Accident and Health Contracts
Liability for Deposit-Type Contracts
Contract Claims

Relevant Statements of Statutory Accounting Principles (SSAPs)

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

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

Note: Risks within this key activity may warrant additional procedures or consideration at the Head of the Internationally Active Insurance Group (IAIG) or level at which the group manages its aggregated risks. Refer to Section 1, Part I for additional guidance for examinations of IAIGs.
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<tr>
<td><strong>Other Than Financial Reporting Risk</strong></td>
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<tr>
<td>The board of directors (or committee thereof) is not involved in establishing and/or reviewing the insurer’s overall reserving policy.</td>
<td>ST RV</td>
<td>Other</td>
<td>RA</td>
<td>The insurer’s board of directors (or committee thereof) has adopted and/or reviewed the insurer’s overall reserving policy.</td>
<td>Verify that the insurer has established overall reserving policy that have been adopted and/or reviewed by the board of directors (or committee thereof).</td>
<td>Obtain information on the insurer’s overall reserving policy and forward it to the insurance department actuary or an independent actuary for review.</td>
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<td></td>
<td>Discuss with members of the board of directors (or committee thereof) their level of involvement in monitoring the implementation of reserving policy.</td>
</tr>
<tr>
<td>The insurer has not taken appropriate steps to prepare for the implementation of Principle-Based Reserving (PBR).</td>
<td>RV ST</td>
<td>Other</td>
<td>RA RD</td>
<td>The insurer has a PBR implementation plan that includes consideration of staffing needs and appropriate expertise in current and/or future budgets and strategic plans.</td>
<td>Verify that budgets and/or strategic plans contain consideration of PBR implementation needs including qualified staff.</td>
<td>Review the insurer’s PBR implementation plan for reasonableness.</td>
</tr>
<tr>
<td>Note: Under the requirements of the Valuation Manual, companies have until 1/1/2020 to implement PBR requirements. See Section 1, VI, for further information on</td>
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<td></td>
<td>Review actuarial department staff qualifications to determine if suitability requirements are met and/or determine if actuarial staff has adequate training available for implementation of PBR. Consider involving an IT specialist in a review of system capabilities</td>
</tr>
<tr>
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<tr>
<td>the implementation of PBR.</td>
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<td>The insurer has a process to monitor the progress and ongoing needs of PBR implementation. Progress includes consideration of exempted products.</td>
<td>Review the insurer’s procedures to determine if pending PBR implementation needs are continuously monitored by company personnel. Consider if certain products have been exempted and the appropriateness of that determination.</td>
<td>necessary for PBR implementation.</td>
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<td></td>
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<td></td>
<td>Data reporting and system needs are reviewed by management on a periodic basis in preparation for PBR implementation.</td>
<td>Verify that management reviews data reporting and system needs.</td>
<td></td>
</tr>
</tbody>
</table>

### Financial Reporting Risks

<p>| In-force data is not complete or accurate nor consistent with accounting records | OP RV | CO AC | RD | The insurer has established appropriate internal controls over the input and maintenance of in-force data as outlined in the Examination Repository – Underwriting. The in-force data is tested periodically by the insurer’s quality assurance (QA) function for completeness and accuracy. The insurer’s system is programmed to issue insurance contracts utilizing sequential policy numbers. In-force database is | Perform tests to verify the operating effectiveness of policy in-force controls as outlined in the Examination Repository – Underwriting. Review the QA reports relating to the testing of in-force data to verify the operating effectiveness of the controls. Verify through observation and/or reperformance that system parameters prohibit the issuance of non-sequential policy numbers. Ensure management review of exceptions. Test reconciliation process | Obtain a copy of the listing detailing in-force insurance contracts provided to the insurer’s actuary. Perform procedures to verify the completeness of this listing by tracing to the database a sample of contracts selected from sources outside the reserve system (e.g., premium cash collections). Use control totals for face amount, benefits, and policy count in order to detect use of incorrect files.* In conjunction with the testing performed in the Examination Underwriting Repository, select a sample of in-force insurance contracts within the system to trace to the underlying... |</p>
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</thead>
<tbody>
<tr>
<td>The data utilized in the company’s PBR model is not representative and consistent with the company’s in-force data.</td>
<td>OP RV AC CO RD</td>
<td></td>
<td></td>
<td>reconciled to accounting records on a periodic basis.</td>
<td>for supervisory review, appropriateness and operating effectiveness.</td>
<td>contract in order to verify that the system data reflects the actual insurance contract provisions and relevant attributes that are deemed significant by the actuary.*</td>
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<td>Review complaint logs for misapplied payments, missing policy documentation and investigate the status of the complaint.</td>
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<td>Reconcile data elements to AS reporting.</td>
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<td>Perform analytical procedures to verify the completeness and accuracy of in-force data.</td>
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<td>Compare in-force aggregation and statistics for products under scope of PBR to model output reports at period zero for attributes such as:</td>
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<td>*Average issue age</td>
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<td></td>
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<td>*Gender distribution</td>
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<td>*Total policy counts</td>
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<td>*Total face amounts</td>
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<td></td>
<td></td>
<td>*Total fund values</td>
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<td></td>
<td>*Total annualized premium</td>
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<td>If concerns are noted, select a sample of policies from the company’s PBR model and obtain the valuation</td>
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<tr>
<td>In-force data is not appropriately restricted and protected to maintain accurate and complete data.</td>
<td>OP</td>
<td>AC</td>
<td>RA</td>
<td>Data utilized in the PBR model is reconciled to in-force records on a periodic basis.</td>
<td>Test reconciliation process for supervisory review, appropriateness, and operating effectiveness.</td>
<td>system audit trail (cash flows discounted back to the reserve value). With the help of an actuary, identify significant attributes of the policyholder and validate them by agreeing back into the administrative system.</td>
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<td></td>
<td>CO</td>
<td>CO</td>
<td>EX</td>
<td>The insurer maintains logical access controls, including password protection and active directories, to properly restrict access to in-force data.</td>
<td>Test the operating effectiveness of logical access controls by reviewing documentation relating to requests for access and by attempting to have unauthorized individuals access the in-force data.</td>
<td>Select a sample of in-force policy data at the examination as of date for accuracy and completeness testing. *</td>
</tr>
<tr>
<td></td>
<td>RD</td>
<td>RA</td>
<td>RD</td>
<td>The insurer has appropriately segregated its duties to ensure that individuals with the ability to update in-force data do not have conflicting responsibilities.</td>
<td>Test the operating effectiveness of segregation controls by attempting to have individuals authorized to access in-force data access claims processing or other systems.</td>
<td>Test a sample of changes made to in-force policies during the year by reviewing supporting documentation.*</td>
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<td>The insurer has established policies and procedures for making accurate, timely changes to policies.</td>
<td>Perform a walkthrough to gain an understanding of the insurer’s process to make changes to in-force policies.</td>
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<td>The insurer has established a QA process to review changes to policies to ensure compliance with the insurer’s policies and procedures on a sample basis.</td>
<td>Test a sample of changes to policies reviewed by the QA function for proper implementation of the insurer’s policies and procedures.</td>
<td></td>
</tr>
<tr>
<td>Reinsurance is not accessible and protected to maintain accurate and complete data.</td>
<td>RV</td>
<td>AC</td>
<td>RD</td>
<td>The insurer has established policies and procedures for making accurate, timely changes to policies.</td>
<td>Review the insurer’s policies and procedures.</td>
<td>Test reconciling items.</td>
</tr>
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<tr>
<td>properly taken into account in accumulating in-force data. (See also Examination Repository – Reinsurance Assuming Insurer.)</td>
<td>CO</td>
<td>RRC</td>
<td>procedures to prepare the in-force data for actuarial review in accordance with the insurer’s reinsurance treaties.</td>
<td>reconciliation reports of actuarial data to the insurer’s in-force system, reinsurance reports, and accounting records. Test the operating effectiveness of the insurer’s established procedures to include in-force data from assumed reinsurance treaties within the data for actuarial review.</td>
<td>relating to reinsurance in-force data for appropriateness. Verify the assumed reinsurance in-force data accumulated for actuarial review by comparing to the data provided by the ceding insurer for completeness. Utilize the NAIC Examination Jumpstart report to compare in-force amounts reported by the assuming insurer to those amounts reported by the ceding insurer.</td>
<td></td>
</tr>
<tr>
<td>The insurer does not properly monitor XXX/AXXX reserve development related to its ceded reinsurance transactions. Note: The Financial Analysis Handbook (V.C. Domestic and/or Non-Lead State Analysis) has several procedures that may be relevant in the evaluation of captive reinsurance transactions and the related reserves.</td>
<td>RV</td>
<td>AC VA</td>
<td>RA RRC</td>
<td>The insurer monitors actual experience on ceded reinsurance relative to the initial or most recent projections and monitors underlying assumptions to evaluate asset adequacy and report any material adverse deviations to management. Review the insurer’s process to monitor experience on ceded reinsurance transactions and verify that material adverse deviations are reviewed by management.</td>
<td>Determine whether the insurer’s ceded reinsurance transactions are tracking appropriately relative to the initial or most recent projections and underlying assumptions. For example, compare actual deaths under the reinsurance transaction with expected deaths assumed in the reserve under the reinsurance transaction. Consider utilizing an actuarial specialist to assist in this determination.</td>
<td></td>
</tr>
<tr>
<td>The assumptions and methodologies used by the insurer for determining the reserves for life, A&amp;H</td>
<td>RV</td>
<td>VA AC PD</td>
<td>RA</td>
<td>The insurer uses consistent assumptions and methodologies that have been based on guidelines outlined in the Valuation</td>
<td>Gain an understanding of the insurer’s assumptions and methodologies and compare with prior periods. Review assumptions and methodologies for reasonableness, appropriateness, accuracy, and compliance with the</td>
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<td>and deposit-type contracts are not accurate or appropriate.</td>
<td>Manual (VM) and Appendix A and Appendix C of the NAIC Accounting Practices and Procedures Manual (to the extent appropriate), adequately documented, approved by senior management, and in accordance with statutory accounting principles (SAP) and applicable state statutes and/or regulations.</td>
<td>Senior management uses internal or independent actuaries to conduct reserve analyses of all major lines of business on an annual basis.</td>
<td>Verify that senior management signs off on assumptions and methodologies used by the insurer, including any changes.</td>
<td>Verifying senior management review of reports from actuaries and that reports include reserve analyses of all major lines of business.</td>
<td>Valuation Manual and Appendix A and Appendix C of the NAIC Accounting Practices and Procedures Manual, with assistance from the insurance department actuary or an independent actuary. Compare actual investment, mortality, morbidity, lapse, interest crediting strategy and expense experience to assumptions, by line of business and to prior-period assumptions. Verify whether the assumptions surrounding contract claim liabilities are in accordance with the relevant SSAPs, as well as applicable statutes, regulations, pronouncements and/or bulletins. Utilize the insurance department actuary or an independent actuary to perform an independent calculation/estimate of the life reserves and incurred but not reported (IBNR) contract claims liability.</td>
<td>Determine whether the appropriate disclosures have been made in the Notes to the Financial Statements for any changes in reserve methodologies.</td>
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<td>The assumptions used by the insurer to calculate reserves for policies subject to Principle-Based Reserving are not accurate or appropriate.</td>
<td>RV</td>
<td>VA AC PD</td>
<td>RA</td>
<td>The company utilizes the prescribed valuation assumptions of the Valuation Manual to calculate PBR reserves. The company has established a process for determining appropriate margins. The company maintains credible experience data to support all assumptions utilized in PBR reserving, including: - Lapse - Mortality - Morbidity - Premium Persistency - Etc.</td>
<td>Utilize a Department actuary, independent actuary or NAIC Actuarial Modeling support staff to review company documentation that provides support for assumptions and evidence that they are developed in accordance with the requirements of PBR as published in the Valuation Manual.</td>
<td>Utilize a Department actuary, independent actuary or NAIC Actuarial Modeling support staff to verify and validate that the company has followed the requirements of PBR as prescribed in the Valuation Manual in developing assumptions.</td>
</tr>
<tr>
<td>The assumptions used by the insurer to calculate reserves for long-term care insurance (LTCI) policies are not</td>
<td>RV</td>
<td>VA AC</td>
<td>RA</td>
<td>The company maintains credible experience data to support all assumptions utilized in calculating reserves for LTCI policies, including:</td>
<td>Select a sample from experience studies to verify support for and consistency with assumptions used by the company.</td>
<td>Utilize the insurance department actuary or an independent actuary to review assumptions and methodologies for reasonableness,</td>
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Review actuarial reports and compare reports to prior periods. Investigate significant variations.

Review correspondence related to any peer reviews performed for appropriate depth of review.
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| accurate or appropriate to meet reserve adequacy requirements. | | | | • Lapse  • Mortality  • Morbidity  • Interest rate  • Etc. | Review any third-party actuarial work to verify and substantiate the appropriateness of company assumptions. | appropriateness, accuracy and compliance with the *Valuation Manual*.  
  
  Compare actual investment, mortality, morbidity and lapse experience to assumptions.  
  
  Compare assuming assumptions to rate increase assumptions, (e.g., review the *Actuarial Guideline LI—The Application of Asset Adequacy Testing to Long-Term Care Insurance Reserves* (AG 51) filing and compare against rate increase requests) to ensure that assumptions used for pricing and reserving do not materially conflict.  
  
  Review the company’s AG 51 filing and compare assumptions utilized by the company in LTCI reserving against industry standards and those of its competitors.  
  
  Review the company’s AG 51 reporting to identify assumptions underlying the asset adequacy testing memorandum that appear to be an outlier and compare against a subsequent rate increase filing.  
  
  Coordinate with the |
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<tr>
<td>Policies with supplemental or accelerated benefits have not been properly separated and reserved for in accordance with SAP.</td>
<td>OP RV</td>
<td>AC</td>
<td>RA PD</td>
<td>The insurer has a process in which supplemental and accelerated benefits are properly identified and reserved.</td>
<td>Test the process surrounding the identification and reserving of supplemental and accelerated benefits.</td>
<td>Utilize the insurance department actuary or an independent actuary to perform an independent calculation of the reserves of supplemental and accelerated benefits. Verify that reserves are in accordance with SAP.</td>
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<tr>
<td>Policies subject to Principle-Based Reserving are not properly identified or exclusion testing is not appropriately conducted.</td>
<td>RV VA AC PD</td>
<td>RA</td>
<td></td>
<td>Company conducts and reviews exclusion testing in accordance with Valuation Manual instructions.</td>
<td>Review company support and supervisory sign-off for exclusion testing.</td>
<td>Utilize a Department actuary, independent actuary or NAIC Actuarial Modeling support staff to conduct or reperform exclusion testing.</td>
</tr>
<tr>
<td>The life, A&amp;H and deposit-type reserve and IBNR contract claim liability computations are not</td>
<td>OP RV</td>
<td>AC VA</td>
<td>RA</td>
<td>The insurer has an established process that is consistent with the method adopted by the NAIC to calculate the life reserves on</td>
<td>Review the process in place (which may include performance of a walkthrough) to estimate the life reserves.</td>
<td>Utilize the insurance department actuary or an independent actuary to perform an independent estimate of the life reserves.</td>
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<td>performed correctly or the selected estimates are unreasonable.</td>
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<td>an annual basis.</td>
<td>Review the credentials, background and responsibilities of the insurer’s actuarial department.</td>
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<td>The insurer maintains a fully staffed, well-qualified actuarial department.</td>
<td>Obtain actuarial reports to verify whether the insurer is using independent or in-house actuaries to perform the reserve calculations on all major lines of business annually and verify senior management review of reports from actuaries.</td>
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<td>Senior management uses internal or independent actuaries to conduct reserve analyses of all major lines on an annual basis.</td>
<td>If performed in-house, review and test the actuarial peer review process and related sign-offs.</td>
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<td>The actuarial calculations are subject to a peer review process.</td>
<td>Review the meeting minutes of the board of directors (or committee thereof) to verify whether a presentation was given on the actuarial calculation process.</td>
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<td>The insurer’s board of directors (or committee thereof) receives an annual presentation on the actuarial analysis process.</td>
<td>Verify management review of reserve reporting and test the operating effectiveness of procedures in place.</td>
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<td>Management receives regular reports on key ratios and reviews unusual fluctuations on a timely basis to review reserves for adequacy.</td>
<td>Review evidence that the company followed its process in developing and validating its model for use in PBR. Governance of the model and IBNR contract claims liability.</td>
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<td>The methodologies utilized in PBR are not appropriate or the reserve computations</td>
<td>OP</td>
<td>AC</td>
<td>RA</td>
<td>The company has a formal process in place to develop and validate a model for use in PBR. Governance of the process in developing and validating its model for use in PBR.</td>
<td>Utilize a Department actuary, independent actuary or NAIC Actuarial Modeling support staff to perform analytical procedures to review the reasonableness of reserve calculations.</td>
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<td>are not performed correctly.</td>
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<td>actuarial model includes consideration of:</td>
<td>• Security Process  &lt;br&gt;• Software Change Process  &lt;br&gt;• Parameter Setting Process  &lt;br&gt;• Validation Process  &lt;br&gt;• Oversight of Overall Model Processes</td>
<td>in PBR.  &lt;br&gt;Review the credentials, background and responsibilities of the insurer’s actuarial department staff in developing and validating the model used in PBR.</td>
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<td>Model results have undergone peer review and are subject to reasonableness tests, such as:</td>
<td>• The insurer manually calculates Net Premium Reserve (NPR) on selected policies.  &lt;br&gt;• The insurer does movement analysis comparing reserves per 1,000 of face amount with prior periods.  &lt;br&gt;• The insurer performs sensitivity testing on key non-prescribed assumptions.</td>
<td>Ensure that company peer review process is in place and operating effectively.</td>
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The computation of CR, AC, RA The reserving actuary Test the operating Compare the annual
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<td>reinsurance credits within life, A&amp;H and deposit-type reserves are not performed correctly. (See also Examination Repository – Reinsurance Ceding Insurer.)</td>
<td>RV</td>
<td>VA CO</td>
<td>RRC</td>
<td>calculates the reserve on a gross basis and determines the net basis by estimating the reinsurance credits and applying them to the gross reserve.</td>
<td>effectiveness of the insurer’s process for reviewing the reserve analysis to determine whether life reserves have been estimated on a gross basis, including management approval and sign-off.</td>
<td>financial statement net and gross incurred for consistency with reinsurance treaties in place at the insurer. Consider the reasonableness of reinsurance credits taken, based on a review of the insurer’s reinsurance program and treaties in place. Compare the corresponding reserve held by the reinsurer with the credit taken by the insurer and identify all reasons for differences.</td>
</tr>
<tr>
<td>The insurer does not properly adjust the terminal reserve computation back to the reporting date.</td>
<td>OP RV</td>
<td>AC VA</td>
<td>RA</td>
<td>The insurer has a process in place whereby reserve computations are adjusted back to the reporting date.</td>
<td>Test the key controls surrounding the process by which reserve computations are adjusted back to the reporting date.</td>
<td>Utilize the insurance department actuary or an independent actuary to perform an independent estimate of the reserve adjustment back to the reporting date.</td>
</tr>
<tr>
<td>The initial reserves calculated by the actuary do not adequately reflect reserve liabilities.</td>
<td>OP RV</td>
<td>AC VA</td>
<td>RA</td>
<td>The insurer has a process in place by which it computes an asset adequacy test on the calculated life reserves.</td>
<td>Test the key controls surrounding the process by which the reserve adequacy test is calculated.</td>
<td>Utilize the insurance department actuary or an independent actuary to perform an independent estimation of the reserve adequacy test to determine whether the overall reserve liability is adequate.</td>
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<td>Management books reserves that are materially different than the actuary’s best estimate.</td>
<td>OP ST LG</td>
<td>VA AC</td>
<td>RA</td>
<td>Management reviews the asset adequacy test for reasonableness of the reserve amount.</td>
<td>Verify management review of asset adequacy test.</td>
<td>Review the actuarial report, as well as the annual financial statement and other appropriate documentation, to determine whether the insurance has booked the actuary’s best estimate. Review the documentation supporting a deviation from the actuary’s best estimate for reasonableness, if applicable.</td>
</tr>
<tr>
<td>The insurer is not properly accounting for cash surrender value (CSV) on life (including annuities) contracts.</td>
<td>OP LG</td>
<td>OB/OW VA</td>
<td>RA</td>
<td>The insurer has policies in place to ensure the reporting of CSV on life (including annuities) contracts in accordance with SSAP No. 51.</td>
<td>Ensure the policies for the process used to report CSVs on life (including annuities) contracts are periodically reviewed and approved by management.</td>
<td>For a sample of life (including annuities) contracts with cash surrenders, determine whether the CSV is being properly reported.</td>
</tr>
<tr>
<td>Contract claim liabilities are not established or reviewed in accordance with the</td>
<td>RV OP LG</td>
<td>AC VA CO</td>
<td>RA</td>
<td>The insurer has a policy for recording contract claim liabilities and actuaries are involved in establishing and reviewing the policy.</td>
<td>Obtain documentation supporting the insurer’s contract claim liability policy to ensure actuary review and policy adequacy.</td>
<td>For a sample of contract claim liabilities, verify that the calculation is in accordance with the insurer’s policy, applicable.</td>
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<td>insurer’s standards and applicable statutory guidelines.</td>
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<td>Contract claim liabilities are recorded in accordance with the insurer’s policy, applicable statutory guidelines and within a specified time frame. Committees evaluate and strategize claim liabilities involving large or unusual loss contract claim determinations and/or settlements.</td>
<td>For a sample of contract claim liabilities, determine whether contract claim reviews were performed and documented in accordance with the insurer’s policy and applicable statutory guidelines. Obtain minutes and other meeting materials from the meetings of the committee to determine whether the committee provided appropriate oversight.</td>
<td>statutory guidelines, and are calculated on a timely basis. From the sample selected above, identify any claims included on the detail for which the liability recorded is not consistent with the contract terms. Identify claims that appear to have not been paid in a reasonable or fair time frame. Investigate the status of these claims/benefits with the insurer’s management.* Verify that the claims/benefits liability is complete and properly recorded at year-end. Obtain a detail of resisted claims and claims closed without payment. Perform procedures to verify the grounds for the resisted claims. For a sample of contract claim liabilities meeting the criteria to go to a loss/benefits committee, determine whether the liabilities were referred to this committee.* Perform an analytical review of loss ratios. If necessary, utilize the insurance department</td>
</tr>
<tr>
<td>The insurer does not maintain an adequate deficiency reserve.</td>
<td>RV</td>
<td>VA</td>
<td>CO CM</td>
<td>The insurer has a process in place to review for premium deficiencies on an annual basis in accordance with SSAP No. 54.</td>
<td>Review the process in place and verify key controls surrounding the calculation of premium deficiency reserves.</td>
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<td>Independent actuaries review and sign off on deficiency reserve calculations.</td>
<td>Obtain the actuarial opinion and verify approval of deficiency reserve calculations.</td>
<td>actuary or an independent actuary to perform a detailed review or an independent calculation/estimate of the premium deficiency reserves.</td>
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Annual Statement Blank Line Items

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

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

Relevant Statements of Statutory Accounting Principles (SSAPs)

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

No. 5R Liabilities, Contingencies and Impairments of Assets – Revised
No. 53 Property and Casualty Contracts – Premiums (P&C Companies)
No. 54R Individual and Group Accident and Health Contracts
No. 55 Unpaid Claims, Losses and Loss Adjustment Expenses
No. 57 Title Insurance
No. 62R Property and Casualty Reinsurance – Revised
No. 63 Underwriting Pools
No. 65 Property and Casualty Contracts
No. 70 Allocation of Expenses

Note: Risks within this key activity may warrant additional procedures or consideration at the Head of the Internationally Active Insurance Group (IAIG) or level at which the group manages its aggregated risks. Refer to Section 1, Part I for additional guidance for examinations of IAIGs.
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<td><strong>Other Than Financial Reporting Risks</strong></td>
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<tr>
<td>The board of directors (or committee thereof) is not involved in establishing and/or reviewing the insurer’s overall reserving policy.</td>
<td>OP RV ST</td>
<td>Other</td>
<td>RA</td>
<td>The insurer’s board of directors (or committee thereof) has adopted and/or reviewed the insurer’s overall reserving policy.</td>
<td>Verify that the insurer has established an overall reserving policy that has been adopted and/or reviewed by the board of directors (or committee thereof).</td>
<td>Obtain information on the insurer’s overall reserving policy and forward it to the insurance department actuary or an independent actuary for review.</td>
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<td>The board of directors (or committee thereof) regularly discusses reserving issues/levels and receives reports from the Appointed Actuary.</td>
<td>Review board of directors (or committee thereof) minutes to ensure discussion of reserving. Verify that the minutes indicate that the Appointed Actuary reported to the board of directors (or committee thereof) on the items within the scope of the actuarial opinion and identifies the manner of presentation.</td>
<td>Discuss with members of the board of directors (or committee thereof) their level of involvement in the monitoring of reserving policy.</td>
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<td>The insurer monitors and revises its reserving policy as needed.</td>
<td>Obtain information on revisions made by the insurer to its reserving policy and verify the revisions were appropriately reviewed and/or approved by the board of directors (or committee thereof).</td>
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<td><strong>Financial Reporting Risks</strong></td>
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<td>New claims are not entered into the claims management system; i.e., claims population is not complete.</td>
<td>RP LG</td>
<td>AC CT CO</td>
<td>RD</td>
<td>Segregation of duties exists between the claim notification and the input of claims data into the claims system.</td>
<td>Observe that segregation of duties exists between the claim notification and the input of claims data into the claims system.</td>
<td>Select a sample of items from the exception reports and verify that the claim was appropriately accounted for.*</td>
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<td>Control reports exist to ensure all claims reported to</td>
<td>Obtain the exception report and ensure management</td>
<td>Select a sample of claims and expense payments made</td>
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<td>the insurer electronically or manually have been entered into the claims system. Exceptions are identified and resolved timely.</td>
<td>review and exception resolution.</td>
<td>subsequent to year-end to verify that claims were recorded in the proper period.</td>
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<td>The insurer reviews the Type II SOC 1 report and ensures compliance with user control considerations for any outsourcing companies that enter claims on behalf of the insurer.</td>
<td>Test the operating effectiveness of the automated claims posting process through reperformance and observation, which could include IT testing of batch totals to ensure completeness of transactions processed.</td>
<td>Review the Type II SOC 1 report, including any bridge letters, to ensure there are no significant control deficiencies or internal control weaknesses related to processing new claims into the claims system.</td>
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<td>Obtain documentation of the management’s review of the Type II SOC 1 report.</td>
<td>Obtain documentation of the management’s review of the Type II SOC 1 report.</td>
<td>Perform analytical procedures to verify the claims were recorded in the correct period; i.e., average claim count before and after period-end.</td>
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<tr>
<td>Claims data (e.g., claim attributes) in the claims database is inaccurate or incomplete.</td>
<td>OP LG</td>
<td>AC CT CO EX</td>
<td>RD</td>
<td>Claims data is subject to independent verification or quality assurance (QA) reviews.</td>
<td>Obtain documentation of independent claim verification or QA review. Ensure reviews performed address the completeness and accuracy of underlying claims information entered into the claims system.</td>
<td>Perform data validation tests to verify the accuracy of claim information maintained in the claims system — such as coverage terms, demographic data, loss occurrence and/or loss report date, date of service, insured name, claim number, paid claim date, paid claim amount, and coverage period — by vouching the information to the claimant’s insurance contract, claims form and any other underlying support. Utilize an actuary to determine the most significant lines of business.</td>
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<td>The claims system has automated controls that will not allow a claim to be entered without a valid in-force policy.</td>
<td>Test the operating effectiveness of automated controls (i.e., edit checks) through reperformance and observation.</td>
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<td>The third-party administrators (TPAs) or managing general agents (MGAs) are not processing claims</td>
<td>LG OP RP</td>
<td>AC CM</td>
<td>RD</td>
<td>claim data has been entered. Entering a valid active policy number will automatically populate select policy data. System edits will identify data that does not meet the predetermined criteria, such as an invalid social security format or missing provider name, resulting in inclusion on a system generated exception report. Segregation of duties exists between individuals responsible for new claim set-up and those responsible for setting up new policies.</td>
<td>Test the operating effectiveness of authority restrictions through reperformance and observation.</td>
<td>and data points used in the estimate, and focus accuracy testing on those. * Scan the database(s) for internal inconsistencies, such as missing claim amounts, unusually small amounts and claims misclassified by type. In situations where adequate segregation of duties is not apparent, obtain data to determine whether any claims were set up by the same user who created the corresponding policy in the master file. If any instances are identified, investigate the claim to ensure the claim exists and is supported by underlying data. Perform analytical procedures over the population of claims data—i.e., paid claims—at the appropriate disaggregation level to identify any unusual trends or anomalies pertaining to the accuracy of claims data that should be further investigated.</td>
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</table>

The insurer performs regular audits of its TPAs/MGAs to determine whether the insurer’s claims-handling standards | Review audit reports and other documentation to determine whether the insurer provides sufficient oversight of its | Determine, by a review of selected claims, whether the insurer is settling its claims accurately and in accordance with the |
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<th>Identified Risk</th>
<th>Branded Risk</th>
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<th>Possible Test of Controls</th>
<th>Possible Detail Tests</th>
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<td>in accordance with the insurer’s claims procedures as outlined in the TPA agreement.</td>
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<td>and additional contract provisions are being consistently followed by the TPA.</td>
<td>TPAs/MGAs.</td>
<td>contract, based on information contained in the claim file.</td>
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<td>Management obtains a Type II SOC 1 report for all TPAs and reviews the report to verify the TPA has adequate controls and that the insurer is adhering to user control considerations.</td>
<td>Verify that the insurer has obtained and reviewed each TPA’s Type II SOC 1 report, if available. Determine whether the insurer is adhering to user control considerations.</td>
<td>Review the Type II SOC 1 report to determine whether the controls outlined in the report are adequate to ensure that claims are being processed in accordance with the TPA agreement.</td>
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<td>Management performs necessary reviews to comply with applicable state MGA regulations.</td>
<td>Obtain evidence of management’s review of compliance with applicable state MGA regulations.</td>
<td>Test for compliance with applicable state MGA regulations.</td>
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<td>Claims are not being processed accurately and in accordance with the insurer’s guidelines.</td>
<td>OP ST LG AC CM CO RD</td>
<td></td>
<td>The insurer has administrative policies and maintains a claims procedures manual that outlines the following requirements:</td>
<td>Review the insurer’s claims manual to determine appropriateness including management approval.</td>
<td>Perform tests to determine whether claims were accurately processed in accordance with the claims procedures manual, approved authority limits and administrative policies, through review of the claimant’s insurance contract, claims form and any other underlying support.*</td>
<td>Review policyholder complaints and investigate significant issues.</td>
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<td>• Proper application of deductibles.</td>
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<td>Review a sample of denied claims to ensure compliance with contract and timeliness provisions.</td>
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<td>• Reserving and payment authority and approval levels.</td>
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<td>exceed policy limits, cover ineligible loss causes/types and/or apply to a policy period for which the insurer is not contractually responsible. Any consideration to pay a loss that meets one or more of the aforementioned categories must be processed in accordance with the insurer’s procedures. As part of the claims processing procedures, the insurer obtains adequate documentation before a claim is settled. Claims approval is subject to approved authority limits. A QA review is periodically performed for each claims processor to ensure compliance with the claims-handling policies.</td>
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<td>checks to ensure procedures are implemented through reperformance and observation. Review assessments of the claims-handling process performed by internal/external auditors, reinsurers and/or others for significant issues. Test the operating effectiveness of controls to ensure adequate documentation is obtained before payment is made. Test the controls in place to ensure that claims are approved in accordance with documented authority limits. Review documentation of QA reviews to determine whether the QA function is being executed as outlined in the insurer’s policies. On a sample basis, reperform the QA testing to ensure that the testing was completed accurately.</td>
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<td>Claims under claims-made liability policies are improperly performed. The insurer has a policy in place whereby coverage is automatically triggered.</td>
<td>RP</td>
<td>AC</td>
<td>RD</td>
<td>Perform a walkthrough to verify that the adjuster properly applies tail</td>
<td>Perform data validation testing to ensure that claims under claims-made liability are properly applied.</td>
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<td>accepted (or rejected) by the claims adjusters.</td>
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<td>under claims-made liability policies when a claim is first made during the policy period (as long as it did not occur prior to the retroactive policy date specified).</td>
<td>coverage to the claim and reallocates the claim to the correct policy year.</td>
<td>policies are being properly administered.</td>
</tr>
<tr>
<td>The claims data utilized by the actuary to estimate reserves does not correspond to the data in the insurer’s claims system and to the data in the insurer’s accounting records.</td>
<td>OP</td>
<td>AC</td>
<td>RD</td>
<td>The insurer has established procedures to reconcile actuarial data to the insurer’s claims system, the data in the insurer’s accounting records and appropriate annual financial statement schedules and/or exhibits. Such reconciliations are reviewed by supervisory personnel.</td>
<td>Review the insurer’s reconciliation reports of actuarial data to the insurer’s claims system and the insurer’s accounting records. Ensure evidence of supervisory review.</td>
<td>Test any reconciling items within the reconciliations for appropriateness. Reconcile the insurer’s actuarial report for losses and loss adjustment expenses, among other significant data inputs (e.g. paid claims, case reserves, etc.) according to the actuary, to supporting insurer reports/underlying documentation, general ledger, and annual financial statement schedules and exhibits as of the valuation date. Vouch payment of claim into bank statement.</td>
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<td>RV</td>
<td>CO</td>
<td></td>
<td>Inventories of reported and unpaid claims are maintained and periodically reconciled to the general ledger.</td>
<td>Review the insurer’s reconciliation of reported and unpaid claims to the general ledger.</td>
<td>Test completeness of the data by gap testing sequences of checks and</td>
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<td>The company’s internal Appointed Actuary reconciles the claims data used in the analysis to Schedule P with proper</td>
<td>Review the company’s internal Appointed Actuary’s reconciliation of the claims data used in the analysis to Schedule P,</td>
<td>Test completeness of the data by gap testing sequences of checks and</td>
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<tr>
<td>Reinsurance is not properly taken into account in accumulating claims data.</td>
<td>RV</td>
<td>AC CO</td>
<td>RD</td>
<td>The insurer has established procedures to prepare the claims data for actuarial review in accordance with the insurer’s reinsurance treaties.</td>
<td>Review the insurer’s reconciliation reports of actuarial data to the insurer’s claims system, reinsurance reports, and accounting records.</td>
<td>Test reconciling items relating to reinsurance loss data for appropriateness. Verifying assumed reinsurance loss data accumulated for actuarial review by comparing to the data provided by the ceding insurer for completeness.</td>
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<td>(See also Examination Repository – Reinsurance Ceding Insurer)</td>
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<td>Test the operating effectiveness of the insurer’s established procedures to include loss data from assumed reinsurance treaties within the claims data for actuarial review.</td>
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<tr>
<td>Initial case reserves are not established or reviewed in accordance with the insurer’s standards.</td>
<td>RV CR</td>
<td>AC VA CO</td>
<td>RA</td>
<td>The insurer has a case reserving philosophy, and qualified actuaries are involved in establishing and reviewing the reserving policy. Initial reserves are made in accordance with the insurer’s reserving philosophy and within a specified time frame.</td>
<td>Obtain documentation supporting the insurer’s reserving philosophy. Review the reserving philosophy for actuarial review and policy adequacy. For a sample of loss reserves, determine whether loss reserve reviews were performed and documented in accordance with the insurer’s policy.</td>
<td>For a sample of reserves, verify that the calculation is in accordance with the reserving philosophy and that reserves are calculated on a timely basis. For a sample of reserves meeting the criteria to go to a claims committee, determine whether the reserves were referred to this committee.*</td>
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<tr>
<td>Case reserves are not updated accurately.</td>
<td>RV CR</td>
<td>CO VA</td>
<td>RA</td>
<td>Claims adjusters/supervisors are required to review significant initial case reserves on a timely basis and make adjustments as necessary. The insurer verifies that the TPAs that process claims follow the insurer’s guidelines for setting case reserves on reported claims. Committees are formed to evaluate and strategize claims involving serious injuries, complex claims law, and large or unusual loss reserve determinations or settlements.</td>
<td>Obtain periodic new claims reports and verify the insurer reviews significant initial case reserves and makes adjustments, if necessary, in a timely manner. Obtain minutes and other meeting materials from the meetings of the committee to determine whether the committee provided appropriate oversight.</td>
<td>Select a sample of paid claims and compare the final overall claims settlement with the case reserve to determine whether the reserves are adequate and/or updated accurately.* Verify that the information contained in management reserve reports is accurate and complete and determine whether the appropriate analysis is being used to evaluate the reserves.</td>
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* Denotes control area is high risk.
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<tr>
<td>The insurer is not properly recording case reserves (assumed or ceded) for contracts subject to reinsurance.</td>
<td>RV CR LG</td>
<td>CO VA AC</td>
<td>RA</td>
<td>The insurer has policies in place to verify that case reserves subject to reinsurance are valid and accurate (within contract time frame, covered under the contract, etc.).</td>
<td>Review the insurer’s policies to determine appropriateness, noting management approval.</td>
<td>Perform procedures to determine whether case reserves recorded by the insurer agree with the case reserves of the assuming (ceding) insurer.</td>
</tr>
<tr>
<td>Actuarial analyses relied upon by the insurer’s management in determining carried reserves are not based on appropriate methods and/or reasonable assumptions.</td>
<td>RV VA AC PD</td>
<td>RA</td>
<td>The insurer’s actuarial analyses use appropriate methods and reasonable assumptions that have been based on historical results (to the extent appropriate), adequately documented, approved by senior management (where appropriate) and in accordance with statutory accounting principles and applicable state statutes and/or regulations.</td>
<td>Gain an understanding of the methods and assumptions used in the analyses compared with prior periods. If performed in-house, review and test the actuarial peer review process and related sign-offs. Verify management review of loss/LAE reserve reporting and test the operating effectiveness of procedures in place. Review the credentials, background and responsibilities of the insurer’s actuarial function (internal or external) for appropriateness.</td>
<td>Review the actuarial analyses’ methodologies for appropriateness and assumptions for reasonableness, with assistance from the insurance department actuary or an independent actuary. Verify that reserving methodologies and assumptions are in accordance with the relevant SSAPs related to P&amp;C reserving, as well as applicable statutes, regulations, pronouncements and/or bulletins. Review prior history of loss development, as well as subsequent loss development data to analyze the appropriateness of methodologies and reasonableness of</td>
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<td>line or class of business grouped by accident year and calendar year, as well as other key ratios, and reviews unusual fluctuations on a timely basis to review reserves for adequacy.</td>
<td>Request and review the insurer’s organizational chart and job descriptions to determine whether the functions are separate and distinct.</td>
<td>assumptions.</td>
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<td>The insurer utilizes a fully staffed, well-qualified actuarial function that is under the direction of an actuary that has an Accepted Actuarial Designation, as defined in the NAIC Statement of Actuarial Opinion Instructions, and is experienced in the lines of business written by the insurer.</td>
<td>Interview the Appointed Actuary during the planning phase of the examination to ascertain the degree of influence the insurer’s management has on the Appointed Actuary’s work.</td>
<td>Determine whether the appropriate disclosures have been made in the Notes to the Financial Statements for the changes in the insurer’s reserve methodologies.</td>
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<td>The reserving actuarial unit’s responsibilities are segregated from the pricing actuarial unit, but there is regular communication between the two units.</td>
<td>Review the external auditor’s reserve level calculations, when available, and the Appointed Actuary’s report; independent tests should only be conducted if other tests are not conclusive.</td>
<td>Review actuarial reports and compare reports to prior periods. Investigate significant variations.</td>
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<td>The insurer’s management does not inappropriately influence the methods, assumptions or conclusions of the Appointed Actuary.</td>
<td>Review correspondence related to peer review for appropriate depth of review.</td>
<td>Utilize the insurance department actuary or an independent actuary to perform an independent calculation/estimate of the loss/LAE reserves for significant reserve segments with volatility, if necessary.</td>
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<td>Compare the Appointed Actuary’s assumptions and estimates with those in other available actuarial analyses.</td>
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<td>Catastrophe-type (CAT) claims or large or significant exposure type claims data are not separately identified and evaluated from other claims.</td>
<td>OP RV VA AC RA</td>
<td></td>
<td>The insurer has established procedures to prepare the claims data for actuarial review by extracting CAT claims or large or significant exposure type claims, for a separate reserve analysis.</td>
<td>Test the operating effectiveness of the insurer’s established procedures to prepare the claims data for actuarial review. Review the insurer’s actuarial reserve analysis for incorporation of a separate review of CAT claims or large or significant exposure type claims and that these claims have been extracted from the general claims data and presented separately to the actuary.</td>
<td>Obtain a detailed download of all claim transactions during the examination period. Utilize audit software to verify that claims data appropriately distinguishes CAT claims or large or significant exposure type claims and that these claims have been extracted from the general claims data and presented separately to the actuary.</td>
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<td>Changes in the legal environment or changes in the insurer’s underwriting, case reserving or claims-handling processes are not appropriately considered within the insurer’s reserving assumptions and methodologies.</td>
<td>OP RV VA PD AC ST</td>
<td></td>
<td>The insurer has procedures in place to monitor and communicate changes in the legal environment (e.g., changes in case law, award amounts, trends in the number of claims being litigated) are being taken into consideration by management in a timely manner. The insurer has procedures in place for the underwriting, case reserving and claims-handling units to communicate changes in their processes to the reserving unit in a timely manner.</td>
<td>Review the insurer’s process to monitor changes in the legal environment that may affect the reserving process and reflect changes appropriately in management’s determination of carried reserves. Review evidence of communication between the reserving unit and other relevant insurer units.</td>
<td>Through a review of documentation supporting management’s carried reserves, determine whether changes in the legal environment or changes in the insurer’s internal processes have been properly incorporated.</td>
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<td>The loss and loss adjustment expense (LAE) reserve computations are not performed correctly or the selected estimates are unreasonable.</td>
<td>OP RV</td>
<td>AC VA</td>
<td>RA</td>
<td>The insurer has an established process (although assumptions and methodologies may change) to estimate the loss reserves on an annual basis. The insurer has established processes to estimate the defense and cost containment (DCC) and the adjusting and other (AO) loss adjustment expense reserves on an annual basis. The insurer maintains a fully staffed, well-qualified actuarial department that is under the direction of a fellow (or associate) of the Casualty Actuary Society (FCAS) and is experienced in the lines of business written by the insurer. Senior management uses either internal or independent actuaries to conduct reserve analyses of all major lines on an annual basis. The actuarial calculations are subject to a peer review process.</td>
<td>Review the process in place (which may include performance of a walkthrough) to estimate the loss reserves. Review the processes (which may include a walkthrough) in place to estimate both the DCC and AO loss adjustment expense reserves. Review the credentials, background and responsibilities of the insurer’s actuarial department staff for appropriateness. Obtain actuarial reports to verify insurer is using either independent or in-house actuaries to perform the reserve calculations on all major lines of business annually and verify senior management review of reports from actuaries. If performed in-house, review and test the actuarial peer review process and related sign-offs.</td>
<td>Utilize the insurance department actuary or an independent actuary to perform an independent estimate of the loss reserves. Utilize the insurance department actuary or an independent actuary to prepare an independent estimate of LAE. Perform analytical procedures to review the reasonableness of loss reserve estimates.</td>
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<td>The insurer’s board of directors (or committee thereof) receives an annual presentation on the actuarial analysis process.</td>
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<td>Review meeting minutes of the board of directors (or committee thereof) to verify that a presentation was given on the actuarial analysis process.</td>
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<td>Management receives regular reports on loss ratios (including IBNR) by line or class of business for accident year and calendar year, as well as other key ratios, and reviews unusual fluctuations on a timely basis to review reserves for adequacy.</td>
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<td>Verify management review of loss reserve reporting and test the operating effectiveness of procedures in place.</td>
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<td>Management does not have reasonable support for its carried reserves.</td>
<td>OP ST LG VA PD RA</td>
<td></td>
<td></td>
<td>The insurer has a process in place for determining carried reserves, and management is able to explain its selection.</td>
<td>Review management’s guidelines regarding the determination of carried reserves. Verify that any material changes from the prior year’s reserves and any material differences between carried reserves and the Appointed Actuary’s point estimate are properly documented.</td>
<td>Review the documentation supporting management’s carried reserves, including management’s analysis of the reasonableness of the reserve estimates.</td>
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<td>The board of directors (or committee thereof) reviews management’s best estimate of reserves and challenges such estimates based upon reports received, including the actuarial report from the Appointed Actuary.</td>
<td>Review meeting minutes of the board of directors (or committee thereof) minutes for evidence of a presentation and review of information supporting management’s best estimate of the booked reserves (e.g., the actuarial report).</td>
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<td>The insurer does not maintain an adequate premium deficiency reserve.</td>
<td>RV</td>
<td>VA</td>
<td>RA</td>
<td>The insurer has a process in place to review for premium deficiencies on an annual</td>
<td>Review the process in place and verify key controls surrounding the calculation of premium</td>
<td>Perform an analytical review of loss ratios.</td>
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<td>Q</td>
<td>CO</td>
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<td>basis in accordance with SSAP No. 53.</td>
<td>deficiency reserves.</td>
<td>If necessary, utilize the insurance department actuary or an independent actuary</td>
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<td>OP</td>
<td>CM</td>
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<td>Qualified personnel perform, review, and sign off on premium deficiency reserve</td>
<td>Obtain the premium deficiency reserve calculations, and verify approval and sign-off.</td>
<td>to perform a detailed review or an independent calculation/estimate of the</td>
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<td>calculations.</td>
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<td>premium deficiency reserves.</td>
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Annual Statement Blank Line Items

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

Relevant Statements of Statutory Accounting Principles (SSAPs)

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

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

Note: Risks within this key activity may warrant additional procedures or consideration at the Head of the Internationally Active Insurance Group (IAIG) or level at which the group manages its aggregated risks. Refer to Section 1, Part I for additional guidance for examinations of IAIGs.
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<tr>
<td>The insurer has not developed and followed its overall underwriting strategy.</td>
<td>ST PR/UW</td>
<td>Other</td>
<td>UPSQ</td>
<td>The underwriting strategy indicates the types and lines of business (coverages),</td>
<td>Review documentation demonstrating that the insurer has developed a formal underwriting</td>
<td>Review the insurer’s underwriting strategy for appropriateness.</td>
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<td>geographical areas and other rating classes the organization seeks to write in.</td>
<td>strategy.</td>
<td>Review the information provided within underwriting reports reviewed by management</td>
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<td>The overall underwriting strategy is reviewed, monitored and approved by the board</td>
<td>Review board minutes and/or packets for evidence that the board actively reviews and/or</td>
<td>Review historical premium written detail as well as underwriting and profitability</td>
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<td>of directors on a regular basis.</td>
<td>approves the insurer’s underwriting strategy on a regular basis.</td>
<td>results and determine whether the underwriting strategy is being followed.</td>
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<td>The underwriting department has established and documented goals in accordance with</td>
<td>Review the underwriting department’s goals for compatibility with the insurer’s overall</td>
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<td>the insurer’s overall underwriting strategy.</td>
<td>underwriting strategy.</td>
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<td>The insurer reviews its underwriting performance to identify non-compliance with its</td>
<td>Review the insurer’s process to monitor compliance with underwriting strategy and determine</td>
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<td>underwriting strategy.</td>
<td>if non-compliance is appropriately remediated.</td>
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<td>The insurer has not established and maintained appropriate risk exposure limits</td>
<td>ST PR/UW</td>
<td>Other</td>
<td>UPSQ</td>
<td>The insurer has established and documented risk exposure limits by geography, other</td>
<td>Review documentation of risk exposure limits and evidence of senior management review/</td>
<td>Utilize audit software to review the insurer’s risk exposures for compliance</td>
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<td>(including catastrophe coverage) that are consistent with risk</td>
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<td>rating classes and line of business (coverages) that have been reviewed and</td>
<td>approval. Consider if the risk limits are consistent with the risk appetite and risk</td>
<td>with insurer limits. (For P&amp;C companies, summarize policies by ZIP code, industry</td>
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<td>approved by senior management.</td>
<td>tolerance.</td>
<td>code, policy size, etc.; for life and health</td>
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<td>Possible Controls</td>
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<td>appetite.</td>
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<td></td>
<td>Risk exposure limits established by the insurer consider the direct and indirect impacts of climate change risk.</td>
<td>levels articulated in the company’s ERM process and consider alignment with the company’s reinsurance program.</td>
<td>companies, summarize by risk class, age, medical codes, etc.) for compliance with insurer limits. If the insurer has not identified risk exposure limits, test the risk exposures for appropriateness by considering applicable industry standards and comparison to peer groups. Perform detailed review of risk exposure models and management reports to monitor exposure by risk. Areas to consider include accuracy and completeness of input data, reasonableness of methodology and results as well as management discipline in adhering to risk exposure limits.</td>
</tr>
<tr>
<td>The insurer has not established sufficient pricing practices, resulting in inadequate or excessive premium rates in relation to its assumed risks and expense structure. Consider utilizing an ST PR/UW Other UPSQ</td>
<td>The insurer has developed comprehensive pricing practices that have been approved by senior management. Pricing practices include consideration of future changes in loss</td>
<td>Review documentation of pricing practices and evidence of senior management review/approval.</td>
<td>Review the underwriting and pricing guidelines established by the insurer for appropriateness. Perform analytical procedures to review the insurer’s profitability and history of indicated rates vs.</td>
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<td>Identified Risk</td>
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<td>actuarial specialist to assist with test procedures related to this risk.</td>
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<td>development including the impact of climate change risk.</td>
<td>claim trends including climate change risk and weather variability is considered when establishing rates/prices.</td>
<td>selected/filed rates to evaluate the sufficiency of premium rates.</td>
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<td>The insurer utilizes a fully staffed, well-qualified pricing actuarial function that has experience in all lines of business (coverages) and geographic locations (rating classes) served by the insurer.</td>
<td>Review the credentials, background and responsibilities of the insurer’s pricing actuarial department for appropriateness.</td>
<td>If rates have been subject to insurance department approval, consider whether reliance can be placed on this work.</td>
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<td>The pricing actuarial function has an established process to calculate base premium rates based on historical loss results, trends, principal advisory organizations (ISO, LIMRA, etc.) and/or other appropriate factors (e.g., costs of reinsurance, expense structure, commission rates) and the calculation is subject to a peer-review process.</td>
<td>Perform a walkthrough to gain an understanding of the rate calculation process, and obtain evidence of a peer review of base premium rate calculations and possibly get input from line personnel.</td>
<td>If deemed necessary, utilize the insurance department actuary or an independent actuary to perform a review or independent calculation of base premium rates.</td>
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<td>Regulatory changes are factored into pricing decisions.</td>
<td>Perform a walkthrough of the company’s pricing process and observe how regulatory changes are factored into pricing decisions.</td>
<td>Compare base premium rates utilized by the insurer to industry averages and advisory organization recommendations for reasonableness.</td>
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<tr>
<th>Policies are issued that do not comply with</th>
<th>OP PR/UW</th>
<th>Other</th>
<th>UPSQ</th>
<th>The insurer utilizes a fully staffed, well-qualified</th>
<th>Review the credentials, background and</th>
<th>Test a sample of new policies underwritten to</th>
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<tr>
<td>Identified Risk</td>
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<td>underwriting and pricing guidelines.</td>
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<td></td>
<td>underwriting function that has experience in all lines of business (coverages), geographic locations and other rating classes served by the insurer.</td>
<td>responsibilities of the insurer’s underwriting function (internal and/or external).</td>
<td>determine whether the final underwriting decision (including any deviations from accepted guidelines) was made by someone at an appropriate authority level.*</td>
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<td>The insurer provides initial and ongoing training programs to qualify its underwriting staff to follow the insurer guidelines established.</td>
<td>Review documentation outlining the insurer’s training of underwriting staff.</td>
<td>Test a sample of new policies underwritten for compliance with appropriate underwriting guidelines.*</td>
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<td>Underwriters are restricted in the type and amount of policies that they underwrite by authority levels built into the system.</td>
<td>Test the operating effectiveness of automated controls (i.e., authority levels) through reperformance and observation.</td>
<td>Test a sample of new policies underwritten for appropriate pricing.</td>
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<td>The insurer has established a QA process to review new policies underwritten for compliance with underwriting guidelines on a sample basis.</td>
<td>Re-perform, on a sample basis, testing of policies reviewed by the QA function for proper implementation of the insurer’s underwriting guidelines.</td>
<td>Review certificates of authority for the states and jurisdictions where the insurer is licensed to write business as of the examination date.</td>
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<td>The insurer designates an individual to be responsible for tracking and maintaining licenses for all jurisdictions in which it transacts business.</td>
<td>Review the insurer’s process for tracking and maintaining licenses to write business.</td>
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<td>The insurer has a process in place that requires deviations from pricing or acceptability guidelines to</td>
<td>Review the insurer’s process for reviewing deviations from pricing or acceptability guidelines.</td>
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<td>Identified Risk</td>
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<tr>
<td>Underwriting results are not monitored and updated in order to measure success or failure of business written.</td>
<td>PR/UWST</td>
<td>Other</td>
<td>UPSQ</td>
<td>be pre-approved, reviewed, and/or spot-checked.</td>
<td>Review company reports to determine sufficient oversight of the company’s portfolio.</td>
<td>Review underwriting results for profitability. Consider profitability from a variety of perspectives, including product lines, geographic areas and distribution channels. Discuss any significant variances or discrepancies between planned strategies/budgets/pricing assumptions and actual results with senior management.</td>
</tr>
</tbody>
</table>

A portfolio manager analyzes key portfolio indicators—such as policies in force, new policy count and policy retention—on a monthly, quarterly and annual basis. Actual policy in force counts are compared to the annual policy in force goals to assess the growth or decline in portfolio size.

The company measures underwriting results and key policy characteristics at specific frequencies to uncover unexpected relationships between policy characteristics, variances from pricing assumptions or other factors that may affect portfolio performance.

The company has a process in place to take corrective actions to address product and underwriting problems identified in the portfolio.

Verify management oversight and approval of the measures used to assess underwriting results and variances from pricing assumptions and of the periodic reports used for monitoring portfolio performance.

Verify the company has implemented changes to underwriting guidelines to address policies with
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<tr>
<td>The insurer has developed or implemented marketing or distribution plans that are not feasible or consistent with its business and underwriting strategy.</td>
<td>OP PR/UW</td>
<td>Other</td>
<td>UPSQ</td>
<td>The insurer has established and maintains clear and reasonable goals and objectives regarding marketing and distribution plans (i.e., direct, online, agency network, app, etc.) to achieve its underwriting strategy. Marketing and distribution plans are reviewed and updated on a regular basis to account for changes in the marketplace and consumer preferences.</td>
<td>Review the marketing and distribution plans and obtain evidence of management approval. Determine if the insurer periodically evaluates its marketing and distribution plans and updates the plans, if necessary, to address changes in the marketplace and effectively execute the underwriting strategy. Review evidence of cross-unit communication and consider the frequency/depth of communication in evaluation of the company’s control.</td>
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<td>The insurer has cross-unit meetings prior to product roll out and periodically thereafter on all product lines to ensure business decisions are aligned across units/departments and changes are communicated in a timely manner.</td>
<td></td>
<td>Review the company’s marketing and distribution plans for feasibility and appropriateness in light of market conditions and competition. Review company’s ongoing performance against projections to evaluate the effectiveness of the company’s marketing and distribution efforts.</td>
</tr>
<tr>
<td>The insurer does not effectively oversee its producers, including managing general agents (MGAs) and third-party administrators (TPAs), to ensure that appropriate underwriting and</td>
<td>OP PR/UW</td>
<td>Other</td>
<td>UPSQ</td>
<td>The insurer has developed comprehensive underwriting, pricing and premium processing guidelines and practices that have been approved by senior management and communicated to the MGAs and TPAs.</td>
<td>Review documentation of underwriting, pricing and premium processing guidelines and practices for evidence of senior management review/approval, as well as evidence of communication and training provided to the MGAs and TPAs. Perform analytical procedures to review the underwriting and premium processing results of significant MGAs and TPAs.</td>
<td>If deemed necessary, perform a site visit to examine the underwriting</td>
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<td>premium processing standards are practiced.</td>
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<td>The insurer monitors the underwriting and premium processing results of its MGAs/TPAs through a regular review of relevant ratios. The insurer requires a Type II SOC 1 report be issued for the service provider and reviews annually. The insurer performs regular reviews of its MGAs/TPAs to determine whether insurer underwriting standards are being consistently followed and whether premiums are processed and remitted in accordance with company standards.</td>
<td>Review documentation that provides evidence of regular review of MGA/TPA underwriting and premium processing results by the insurer. Review the service provider’s audited financial statements and Type II SOC 1 report to determine the service provider appears to have a solid financial position and appropriate internal controls. Review any audit reports and other documentation to determine whether the insurer provides sufficient oversight of its MGAs/TPAs.</td>
<td>and premium processing functions at the MGA/TPA.</td>
</tr>
<tr>
<td>The company has not established appropriate rates for its long-term care insurance (LTCI) policies</td>
<td>ST PR/UW</td>
<td>Other</td>
<td>UPSQ</td>
<td>The insurer utilizes a fully staffed, well-qualified actuarial pricing function that has significant experience and expertise in LTCI. The company conducts experience studies and utilizes credible data as the basis for its rate assumptions. The company files accurate</td>
<td>Review the credentials, background and responsibilities of the insurer’s actuarial pricing function for appropriateness. Select a sample from experience studies to verify support for and consistency with rate assumptions used by the company. Communicate with</td>
<td>Perform analytical procedures to review the insurer’s profitability and history of indicated rates vs. selected/filed rates to evaluate the sufficiency of premium rates. Compare the premium rates utilized by the insurer to industry averages and those of competitors (if known) for reasonableness.</td>
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| and complete rate increase requests with all departments in a timely manner. | department staff in charge of LTCI rate review requests (in multiple states if appropriate) to assess the quality and timeliness of the insurer’s rate requests. | If rates have been subject to insurance department approval, consider whether reliance can be placed on this work. If deemed necessary, utilize the insurance department actuary or an independent actuary to perform a review or independent calculation of premium rates.

Compare rate increase assumptions to reserve assumptions, (e.g., review the rate requests and compare against *Actuarial Guideline LI—The Application of Asset Adequacy Testing to Long-Term Care Insurance Reserves* (AG 51) filings) to ensure that assumptions used for pricing and reserving do not materially conflict.

Track the progress of the company in achieving its rate increase goals by comparing rate increases received against those requested. If necessary, evaluate the potential impact of rate request denials on the future solvency position of the insurer.
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<td><strong>Financial Reporting Risks</strong></td>
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<td>Trace a sample of records from the policy data to the database and from the database to the policy data to verify and validate key data elements used in the database. Utilize an actuary to determine the most significant lines of business and data points used in the estimate, and focus accuracy testing on those.</td>
<td></td>
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<tr>
<td>Policy data are not properly and completely entered into the system (See also Examination Repository – Reserves – Claims (Life)).</td>
<td>OP PR/UW</td>
<td>AC CO</td>
<td>UPSQ RA</td>
<td>The insurer’s system contains edit checks that require policy data to be complete and reasonable before being entered into the system.</td>
<td>Test the operating effectiveness of edit checks through reperformance and observation.</td>
<td>Trace a sample of records from the policy data to the database and from the database to the policy data to verify and validate key data elements used in the database. Utilize an actuary to determine the most significant lines of business and data points used in the estimate, and focus accuracy testing on those.</td>
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<td>The insurer has a QA process in place that tests policy data entered into the system on a sample basis.</td>
<td>Re-perform, on a sample basis, QA testing of the application data entered into the system.</td>
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<td>Perform analytical procedures over the population of policy data to identify any unusual trends or anomalies that should be further investigated.</td>
<td>Trace a sample of records from an external source (i.e., bank deposits) to the policy database to ensure all policies are properly recorded in the system.</td>
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<td>Trace a sample of records from an external source (i.e., bank deposits) to the policy database to ensure all policies are properly recorded in the system.</td>
<td>Trace a sample of records from an external source (i.e., bank deposits) to the policy database to ensure all policies are properly recorded in the system.</td>
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<td>Policies are underwritten with high deductibles that expose the company to significant collectibility/credit risk.</td>
<td>ST PR/UW CR</td>
<td>Other UPSQ</td>
<td></td>
<td>The insurer reviews the credit quality of potential policyholders before underwriting high-deductible policies.</td>
<td>Review evidence of credit assessment prior to the approval of high-deductible policies.</td>
<td>Consider reviewing a sample of high deductible policies and evaluate sufficiency of collateral based on ongoing claims activity and credit risk of the insured.</td>
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<td>The insurer requires collateral to be posted and maintained to ensure that deductibles on significant claims can be collected.</td>
<td>Obtain evidence of the insurer’s process to require and maintain collateral at a sufficient level for high-deductible policies.</td>
<td>Perform an analytic to review and assess historical collections.</td>
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<td>Collateral levels and</td>
<td>Review the</td>
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<td>associated claims activity are reviewed on a regular basis to ensure collectibility.</td>
<td>quality/liquidity/availability of collateral held for high deductible policies.</td>
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The following is an illustration of how a summary review memorandum (SRM) may be set up to assist examiners in documenting the key issues and results of a risk-focused examination that should be shared with the Chief Examiner and the assigned analyst. The illustration also includes a high-level overview of the insurer’s holding company structure (if applicable) and how that structure affected exam coordination with other states. Additionally, the SRM includes discussion of the insurer’s governance and risk management practices, and a summary, by branded risk classification, of significant exam findings and/or concerns warranting communication. These findings may include overarching solvency concerns, examination adjustments, other examination findings, management letter comments, subsequent events and other residual risks or concerns the examiner may want to communicate to department personnel. The final sections, prioritization level and changes to the supervisory plan, provide discussion of the examiner’s overall conclusions regarding ongoing monitoring, including specific follow-up recommended to the analyst.

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

COMPANY NAME:      EXAMINATION DATE:

EXAMINATION BACKGROUND

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

CORPORATE GOVERNANCE

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

RISK MANAGEMENT

The purpose of this section of the memorandum is to summarize an understanding and assessment of the insurer’s enterprise risk management (ERM) function of the insurer. This assessment should include information obtained during the planning, fieldwork and completion stages of the examination. In documenting the state insurance regulator’s assessment, regulators may consider using the maturity terminology established within the Risk Maturity Model (RMM); i.e., Leadership,
Managed, Repeatable, Initial and Ad hoc. In documenting the key points for the state insurance regulator’s assessment of the maturity and reliability of the insurer’s ERM function, consideration should be given to the following areas, if applicable:

- Information on key entity level ERM controls that were validated during the examination.
- Summary assessment of significant areas of strength and weaknesses within the ERM framework.
- Work performed to review the company’s capital modeling processes.
- Work performed to review the company’s stress testing framework.
- Evaluation of the company’s key risks, risk appetites, tolerances and limits.
- Evaluation of the company’s capital and surplus; i.e., quality of capital, availability of capital, etc.
- Evaluation of the company’s prospective risk assessment and capital position.
- Recommendations to be made to the company based on ERM work performed.

When the insurer is part of a holding company, documentation should reference the level at which conclusions are reached. Additional assessment may be necessary at the individual entity level, but the primary focus of the assessment will commonly be at the holding company level in a coordinated examination. Documentation should clearly indicate the exam’s utilization and reliance on the company’s ORSA/ERM processes to assist in the identification of key risks and/or controls.

It may also be appropriate to provide additional risk specific commentary related to ERM/ORSA review within the Branded Risk Assessments. Documentation should provide summary level information for key risks, with reference to examination workpapers for additional detail, when necessary. Risk specific commentary should include consideration of the following areas, if applicable:

- New risks for the analyst to consider in its ongoing financial surveillance.
- Risk specific controls/risk mitigation strategies that were validated during the examination.
- Evaluation of risk assessment techniques, including appropriateness of stress scenarios and underlying quantification techniques and assumptions.
- Risks that may require further ongoing surveillance or recommended follow-up by the Department.
- Other sources of information to evaluate key risks not referenced in the ORSA (e.g., key risk indicators, presentations to the BOD, project plans, etc.).

For coordinated examinations of Internationally Active Insurance Groups (IAIGs), or other groups as deemed appropriate, additional documentation may be necessary. This may include discussion of the group’s supervisory plan, an overall assessment of the group’s risk management framework and the criteria considered in reaching that conclusion (e.g., capital adequacy and availability, regulatory capital requirements at the group and legal entity level, complexity of the group and its impact on the effectiveness of the group’s corporate governance, etc.), and other relevant reporting requirements deemed applicable by the group-wide supervisor.

BRANDED RISK ASSESSMENTS

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

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

Risk Assessment Level Considerations:

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

Risk Assessment Trend Considerations:

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

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

### Branded Risk Classification (Example: Credit)

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

#### Analyst Initial Assessment

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

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<tr>
<th>Minimal Concern</th>
<th>Moderate Concern</th>
<th>Significant Concern</th>
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<td>Reinsurance Recoverables</td>
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<td>Real Estate – Home Office</td>
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<tr>
<td>Agent Balances and Uncollected Premiums</td>
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Analyst Initial Overall Assessment: Moderate | Overall Trend: ↔

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

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<th>Minimal Concern</th>
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<td>Agent Balances and Uncollected Premiums</td>
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Examination Overall Assessment: Moderate | Overall Trend: ↔

Recommended Follow-Up

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<th>Issue</th>
<th>Recommended Follow-Up</th>
<th>Timeline</th>
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<tbody>
<tr>
<td>See ML #2 – Lack of a consistent agency audit process</td>
<td>Company was asked to establish a consistent agency audit plan to ensure accurate and complete premium and claim reporting. Analyst is asked to follow-up on company activity in this area by requesting a copy of the audit plan and selecting a sample of agency audit reports to request and review.</td>
<td>Company has stated that it plans to increase its IA staffing over the next six months to support additional agency audits. Therefore, follow-up as part of the next annual financial statement analysis is recommended.</td>
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ISSUES OF NON-COMPLIANCE

The purpose of this section is to describe any issues of non-compliance identified during the examination. These issues typically do not have a significant impact on the assessment of each branded risk classification, but are important to communicate and ensure proper follow-up is performed.

Recommended Follow-Up

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<th>Issue</th>
<th>Recommended Follow-Up</th>
<th>Timeline</th>
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<tr>
<td>See ML #1 – Schedule F reporting</td>
<td>Company was asked to report reinsurance data on Schedule F on a gross basis in all instances. Analyst asked to follow-up by closely monitoring Schedule F and reinsurance Jumpstart reports.</td>
<td>Follow-up recommended in conjunction with quarterly and annual financial statement analysis through 20XX.</td>
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PRIORITIZATION AND ONGOING MONITORING

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

PROPOSED CHANGES TO SUPERVISORY PLAN
The purpose of this section of the memorandum is to propose any changes to the supervisory plan that the examiner believes are necessary based on the preceding information.
OVERVIEW

The intent of the risk assessment process in a risk-focused examination is to identify areas of higher risk in order to enable more efficient use of examiner resources. A key to determining whether potential for material misstatement exists within the financial statements is to evaluate the insurer’s audit function, which is made up of both internal and external audits.

The NAIC Annual Financial Reporting Model Regulation (#205) (commonly referred to as the Model Audit Rule (MAR)) was implemented in order to improve state insurance department surveillance of financial insurers by requiring an annual statutory audit of financial statements, which report the financial position and results of operations of insurers by independent certified public accountants. The primary objective of a statutory audit is to enable the external auditors to express an opinion as to whether the insurer’s statutory financial statements are presented fairly in all material respects in conformity with the accounting practices prescribed or permitted by the applicable state of domicile. Effective in 2010, the MAR has additional requirements, including a mandatory Attestation of Internal Control by management for insurers with premiums greater than $500 million. Portions of the MAR are referenced throughout this document.

External auditors conduct audits in accordance with Generally Accepted Auditing Standards (GAAS) for non-public companies, and the rules and auditing standards of the Public Company Accounting Oversight Board (PCAOB) for publicly traded companies. GAAS require that the audit be conducted with independence, due professional care, ethical standards, objectivity and adequate planning/supervision. The PCAOB is responsible for the development of auditing and attestation standards related to quality control, ethics and independence for publicly traded companies. When these standards are adhered to, the external auditor’s opinion lends credibility to such financial statements and thereby assists in promoting confidence that the insurer’s financial condition is fairly presented.

Insurance companies often establish an internal audit function to assist in fulfilling such responsibilities as safeguarding assets, ensuring reliability of financial records, verifying compliance with internal procedures and assessing the efficiency of internal controls. Depending on the nature and extent of the internal auditor’s work, the examiner may utilize their work to gain an understanding of the internal control structure or to assess control risk for specific identified risks.
As the insurance industry becomes more complex in responding to technological, global and market changes, the roles of the insurance regulator and external auditor become more demanding. In many aspects, insurance regulators and auditors face similar challenges, and increasingly their roles are perceived as complementary. Insurance regulators may utilize external auditors’ work to assist them with their oversight responsibilities. Likewise, the auditors, in carrying out their duties, may also look to the insurance regulators for information that may increase audit effectiveness.

The control documentation required by the audit standards provides state insurance regulators with an enhanced ability to perform a risk assessment and thus should be used to the extent feasible in performing a risk-focused examination. By leveraging off the work performed by the company’s internal and external auditors, insurance regulators may be able to avoid duplication of audit and examination procedures, thereby increasing the efficiency and effectiveness of the examination. If the internal or external auditor’s work is utilized, the examiner should assess and draw conclusions about the quality, adequacy and results of the auditor’s work, including verification of procedures as necessary. The examiner’s professional judgment should be used in determining the extent of the auditor’s work to be reperformed, if any. This judgment should be based on a number of factors, including the risk associated with the testing area and the errors noted by the auditor.

The purpose of this form is to provide guidance for the review and assessment of audit workpapers in conjunction with the state insurance department’s financial examination of an insurer. This form should assist the examiner in understanding the risks identified by the external and internal auditors, how those risks were addressed, and the overall audit conclusions reached. This information may enable the examiner to conduct the risk assessment in a more effective manner. In order to fully understand the risk methodology and work performed by the external and internal auditors, the examiner should meet with the auditors prior to reviewing the workpapers to discuss the methodology regarding specific key areas, including any consideration and attestation of internal controls in accordance with SOX for publicly held companies and the Risk Assessment Standards for non-public companies. This meeting should include key engagement team members, such as the engagement partner or manager, to ensure that information is sourced from those with the most knowledge and understanding of the insurer and its financial statements.

REVIEW GUIDELINES AND INSTRUCTIONS

This form provides the examiner with a guide to facilitate the planning, performance and assessment of the internal and external auditor workpaper review, along with the review of SOX reports. This form should be completed during Phase 1, Part 3 of the risk-focused examination process.

It should be noted that not all insurers will have an internal audit department and, for those that do, the examiner should use professional judgement and consideration of the internal audit department’s independence from management in the reporting structure in placing reliance on the work performed by the internal audit department. For companies where there is no segregation between management and the internal audit function, additional procedures may be required in reviewing the work performed by the internal audit department.

SARBANES-OXLEY ACT OF 2002 CONSIDERATIONS

Section 302, Corporate Responsibility for Financial Reports, requires principal officers to certify annual and quarterly reports. These certifications should provide information regarding the internal control structure, changes to internal controls and possible concerns on material weaknesses or significant deficiencies.

Section 404, Management Assessment of Internal Controls, requires annual reports to include an internal control report identifying management’s responsibility for establishing and maintaining an adequate internal control structure, a management assessment on the effectiveness of the internal control structure, and an independent auditor attestation and opinion report on the assessment made by management.

If available, these documents could significantly assist the examiner in documenting and assessing the insurer’s internal controls over financial reporting. Discussions with the insurer can be useful in the review of these documents in determining what information is pertinent to the examination planning objectives and what information would be most useful to the examiner.
COOPERATION OF EXTERNAL AUDITOR

If the examiner does not receive the full cooperation of the external auditor, the examiner needs to report this occurrence to the company under examination. Examiners may be forced to duplicate audit work already performed if the external auditor does not provide the audit workpapers to the insurance regulators in a timely fashion. Insurance regulators need to be provided with applicable audit workpapers prior to on-site fieldwork, as reliance on audit work will affect the examination scope and extent of additional detail tests.

The American Institute of Certified Public Accountants (AICPA) has developed a four-step process that may be followed by regulators who are experiencing difficulty in obtaining access to external auditor workpapers, who have questions with respect to the external auditor’s individual engagement to perform a statutory audit, or who have concerns about the work performed by the external auditor. The AICPA proposes that the regulator should initially follow the current process of working through the company to obtain access. To increase the chances of success in obtaining the external audit work, examiners are encouraged to notify the external auditor, with the assistance of company personnel, at least six months before the as-of date of an upcoming examination so the auditor can adjust its schedule to make the work available to the examiner earlier. Should the regulator deem that additional response is required, after informing appropriate management, the financial examiner would contact the following individuals in this suggested order, as needed:

1. The engagement partner.
2. The designated national firm representative (see the NAIC website for a listing of Big Four firm contacts).
3. Chair of the insurer’s Audit Committee.
4. State Board of Accountancy, Ethics (or Qualitative Review) Committee, or other regulatory bodies deemed appropriate.

This process, excluding Step 4, is informal, non-authoritative and non-binding. This process is in addition to the remedies available to regulators. The benefits of the additive process would be to help enhance communication between regulators and independent certified public accountants, improve the effectiveness of obtaining access to audit working papers on a timely basis, and assist in strengthening the quality of statutory audits. The AICPA has communicated to practitioners the statutory requirement to provide access to audit working papers and audit-related correspondence as defined by statute.
GENERAL INFORMATION: External

Accounting Firm ____________________________________________

Years on Engagement ________________________________________

Date of Reports _____________________________________________

Independent Accounting Firm Contacts:

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GENERAL INFORMATION: Internal

Accounting Personnel ________________________________________

Years of Experience ________________________________________

Scope of Audits ___________________________________________  

Date of Reports ___________________________________________

Internal Audit Contacts:

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External Auditor Workpaper and Report Review

1. Obtain the external auditor’s engagement letter to ensure that there are no indemnification clauses or other unusual items included in the engagement letter.

**Guidance Point:** An indemnification clause between an insurer and an external auditor automatically breaches the independence of that auditor. If an indemnification clause exists, whether directly or indirectly, the examiner must evaluate whether it is reasonable to place reliance on the work of the external auditor. Additionally, the inclusion of an indemnification clause in a statutory auditing engagement letter is a breach of independence as outlined in the AICPA Ethics Interpretation 501-8.

2. If not already performed by the financial analyst, obtain the following correspondence as required by the NAIC Annual Financial Reporting Model Regulation. Evaluate the content of the correspondence for consideration in the planning phases of the examination.

   a. An “Awareness Letter” noting the external auditor’s understanding of the insurance codes and regulations applicable to the insurer and affirming that the opinion expressed on the financial statements is in terms of their conformity to the statutory accounting principles.

   b. If there was a change in auditor since the last examination, obtain the following documents:

      i. A “Notification Letter” from the insurer to the commissioner stating whether, in the 24 months preceding the change in auditor, there were any disagreements with the former auditor.

      ii. A “Confirmation Letter” from the former auditor stating whether they agree with the statements contained in the insurer’s “Notification Letter” and, if not, stating the reasons for which he or she does not agree.

   c. A “Qualification Letter” from the external auditor which includes the following representations:

      i. The auditor is independent.

      ii. The audit staff assigned to the engagement have sufficient background, designations and experience, in general, and the experience in audits of insurers.

      iii. The auditor’s opinion will be filed in compliance with regulation.

      iv. The auditor consents to make available for review all workpapers and communications obtained as part of the audit to the examiner.

      v. The auditor is properly licensed by an appropriate state licensing authority and is a member in good standing with the AICPA.

      vi. The auditor meets the qualifications of an Independent Certified Public Accountant as defined in Section 7 of the NAIC Annual Financial Reporting Model Regulation.
d. “Notification of Adverse Financial Condition,” if applicable, outlining the reasons for the classification of Adverse Financial Condition.

e. “Communication of Internal Control Related Matters Noted in an Audit,” which outlines any unremediated material weaknesses noted during the audit.

3. If not already performed by the financial analyst, obtain a copy of all recorded and unrecorded audit adjustments for the most recent year of the examination period (or multiple years of the examination period, if deemed necessary), along with supporting documentation regarding the adjustments or explanations from the external auditor. Evaluate the adjustments for consideration in the planning phases of the examination.

*Guidance Point:* The examiner should use information regarding audit adjustments identified by the external auditor in identifying risks or internal control weaknesses. This consideration should be documented within the examiner’s workpapers.

4. If not already performed by the financial analyst, obtain a copy of the signed management representation letter for the most recent year of the examination period (or multiple years of the examination period, if deemed necessary), which acknowledges that management is responsible for the presentation of the financial statements and has considered all uncorrected misstatements and concluded that any uncorrected misstatements are immaterial, both individually and in the aggregate. (Practice Alert 94-1: Dealing with Audit Differences; SAS 89: Audit Adjustments)

   a. Review the entire management representation letter to determine if there are any non-standard representations or representations that would have an impact on the examination.

5. If not already performed by the financial analyst, obtain a copy of the internal control-related matters presentation materials for the most recent year of the examination period (or multiple years of the examination period, if deemed necessary), including the Management Letter, prepared by the external auditor for the audit committee’s review. Verify that the presentation took place through review of audit committee meeting minutes.

*Guidance Point:* The external auditor is required to provide written communication to the audit committee of all significant deficiencies or material weaknesses known by the external auditor. These comments from the external auditors should be a good guide as to what areas will need additional testwork.

6. If not already performed by the financial analyst, obtain from the external auditor a copy of the independent statutory audit report and opinion for the most recent year of the examination period (or multiple years of the examination period, if deemed necessary).

   a. Verify that the audit report has an unmodified audit opinion, except with regard to the use of prescribed or permitted practices related to statutory accounting in the insurer’s state of domicile. If an unmodified opinion was not issued, document the rationale for the modified opinion (e.g. qualified, adverse) and how this was considered during the examiner’s risk assessment process.
b. Identify any issues (material findings, contingencies, subsequent events, etc.) that should be considered during the examination. Document any issues noted and how they were considered during the examiner’s risk assessment process.

c. Ensure that the audited financial statements reconcile to the annual statement. If not, the examiner should ask the external auditor to provide an explanation for any differences.

7. Discuss the audit with key members of the external audit engagement team. Inquire if there were any concerns with regard to the company under examination. The examiner should document any issues identified by the external auditor and consider those issues, if any, to assist in the planning phases of the examination.

**Guidance Point:** This discussion should include, but not be limited to, audit scope and planning, audit methodology and audit findings. The examiner should obtain a copy of the external auditor’s risk assessment if one was not provided in the workpapers. Upon request of the state insurance department conducting the regulatory examination, the audit partner in charge of the engagement should be available for potential questions regarding the audit.

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

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

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

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

b. Determine whether any workpapers will be excluded from the examiner’s review and document the rationale for the exclusion.

c. If the external auditor utilized work previously completed by the internal audit department or used the internal audit staff in completing any of their planned audit procedures, obtain supporting documentation of the external auditor’s use of the internal audit department. (See the “Internal Auditor Workpaper and Report Review” section for additional procedures relating to the internal audit function.)

d. Review the workpapers at a high level to identify the internal controls reviewed or tested by the external auditor. Consider whether the external auditor had reviewed
different control procedures in prior year audits and obtain the relevant workpapers from prior years as appropriate.

**Guidance Point:** Note that external auditors often test internal controls on a rotational basis. Therefore, it may be necessary for the examiner-in-charge to request prior year workpapers from the external auditor in addition to the current year workpapers. The examiner may place reliance on testing from prior years if they are able to determine that the controls have not significantly changed.

e. Document and evaluate any discrepancies or findings noted during the high-level review of the workpapers.

9. Obtain a copy of the external auditor’s documentation in relation to AU Sec. 316—*Consideration of Fraud in a Financial Statement Audit*. The AU 316 documentation should assist the examiner in completing Exhibit G – Consideration of Fraud.

**Guidance Point:** The fraud risk factors identified by the external auditor in relation to AU 316 and by the examiner in Exhibit G should impact the examiner’s consideration of risks inherent within the entity and impact the overall risk assessment and examination procedures completed by the examiner.

10. Obtain copies of all legal letters obtained by the external auditor.

   a. Review the legal letters to identify common themes or pending issues pertaining to insurer operations or class-action lawsuits that may impact the assessment of identified or potential risks.

   b. Review the legal letters to determine the scope of further communication with legal counsel regarding litigation, claims, assessments and unasserted claims.

**Guidance Point:** Risks identified within legal letters would most likely be classified as legal, reputation or operational risks.

11. If the external auditor relied on a report of internal controls (SOC 1) provided by the insurer’s service provider (data processing, claims processing, etc.), consider the adequacy of the external auditor’s use and reliance of the report within their audit workpapers to facilitate the examination process.

   a. Consider the documentation within the external or internal auditor’s workpapers describing the consideration of any SOC reports and any assessment of risks resulting from the SOC report findings in completing the overall risk assessment.

12. Obtain and review copies of the workpapers relating to the review and assessment of the company’s Information Technology (IT). If necessary, include department IT staff in the review.

**Guidance Point:** The review of IT should be done in conjunction with the completion of Exhibit C – Evaluation of Controls in Information Technology.

13. If the insurer is required to comply with SOX, obtain the following reports and determine what impact, if any, the content may have on the scope and extent of the examination:
a. Section 302, *Corporate Responsibility for Financial Reports*, which includes certification from principal officers of the annual and quarterly reports.

b. Section 404, *Management Assessment of Internal Controls*, which includes a management assessment on the effectiveness of the internal control structure and an independent auditor attestation and opinion report on the assessment made by management.

**Internal Auditor Workpaper and Report Review**

14. Obtain and document an understanding of the internal audit department’s role in the internal control structure, including recent changes in the internal audit department, such as personnel, approach and reporting relationship changes.

   a. Determine that the board of directors and senior management are restricted from delegating their responsibilities for establishing, maintaining and operating effective audit activities (e.g., establishment of an annual audit plan that is reviewed by the audit committee).

   b. Determine that audit activities are performed by an independent and qualified staff that is objective in evaluating the insurer’s financial reporting risks and internal controls, including management information systems. *In order to be independent, Internal Audit members should not have other operational, risk management or accounting responsibilities.*

15. If the internal audit department is deemed independent and qualified, obtain documentation of all the internal audits conducted by the internal audit department since the previous examination. Perform a high-level review of selected internal audit reports to determine whether:

   a. Audit activities help maintain or improve the effectiveness of insurer risk management processes, controls and corporate governance.

   b. Audit activities provide reasonable assurance about the accuracy and timeliness of recorded transactions and the accuracy and completeness of financial reports.

   c. Audit activities provide assistance, guidance and/or suggestions where needed.

16. After review of internal audit reports, if the examiner has determined that the internal audit department is competent, the internal audit department may be used for preparing examination workpapers.

**Conclude on the Review of Internal and External Audit Functions**

17. Follow up on any unresolved questions and issues identified during the review of the auditors’ workpapers. Document any issues and responses provided.

18. Prepare a memorandum documenting:

   a. The overall review of the internal and external auditors’ workpapers.
b. The examiners assessment and conclusion on the competency and adequacy of external and internal audit documentation as part of the corporate risk management process.

c. The examiners conclusion regarding whether a review of financial reporting risks can be reduced based on the effectiveness of the insurer’s audit function.
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EXHIBIT M  
UNDERSTANDING THE CORPORATE GOVERNANCE STRUCTURE

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

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

Holding Company Considerations
In conducting examinations of insurers that are part of a holding company group, including Internationally Active Insurance Groups (IAIGs), the work to gain an understanding and perform an assessment of corporate governance should focus on the level at which insurance operations are directly overseen (e.g., Head of the IAIG, ultimate parent company level, insurance holding company level, legal entity level, etc.). However, in certain areas, it may be necessary to also review governance activities occurring at a level above or below the primary level of focus. Many critical aspects of governance usually occur at the holding company level. Furthermore, if the insurer under examination belongs to a holding company group that has been identified as an IAIG, group level governance practices must be evaluated. Because of these factors, the exam team should seek to coordinate the review and assessment of group corporate governance in accordance with the exam coordination framework and lead state approach outlined in Section 1 of this Handbook.

Where possible, in a coordinated examination, the lead state’s work on the corporate governance assessment should be utilized to prevent duplication of effort and to leverage examination efficiencies. Additionally, the examiner should utilize the Corporate Governance Annual Disclosure (CGAD), which is required to be filed with the Department of Insurance (DOI) annually in accordance with the Corporate Governance Annual Disclosure Model Act (#305) and Corporate Governance Annual Disclosure Model Regulation (#306). The CGAD provides a narrative description of the insurer’s or insurance group’s corporate governance framework and structure and may enhance examination efficiencies when leveraged. Examiners should ensure they understand/leverage the work performed by the lead state’s analyst, including the Holding Company Analysis work performed by the lead state’s financial analyst and, as well as the lead state’s review of the ORSA filing and Corporate Governance Annual Disclosure (CGAD).

The CGAD is required to be filed with the Department of Insurance (DOI) annually in accordance with the Corporate Governance Annual Disclosure Model Act (#305) and Corporate Governance Annual Disclosure Model Regulation (#306). The CGAD provides a narrative description of the corporate governance framework and structure for insurers and insurance groups, including IAIGs, and may enhance examination efficiencies when leveraged to understand and assess the company’s corporate governance, as well as the filings noted above.

A. ASSESSING THE BOARD OF DIRECTORS

An assessment of the board of directors may be determined through discussions with the board of directors and through gaining an understanding of the board’s oversight role. The overall assessment should cover the suitability of board members, as well as the suitability, policies and practices of the board as a whole. As a general guideline, the following areas should be considered in the assessment of the board of directors:
1. Are membership criteria and terms for the board of directors sufficient to enable the effective monitoring and oversight of management?

2. Are board members suitable for their respective roles in supporting the overall objectives of the insurer? An assessment of suitability may include consideration of knowledge, experience, competence and integrity of members. Any concerns identified as a result of the assessment of suitability of individual board members and the board as a whole, should be documented and communicated as appropriate.

3. Does the board of directors effectively monitor and oversee management activities?

4. Is the board of directors sufficiently independent from management such that, when necessary, difficult and probing questions are raised? If not independent, what compensating factors, if any, exist to ensure that, when necessary, difficult and probing questions will be raised with or considered by management?

5. What is the frequency and timeliness with which meetings are held with chief financial and/or accounting officers, internal auditors and external auditors?

6. Is the information provided to the board of directors or committee members sufficient and timely enough to allow monitoring of management’s objectives and strategies, the entity’s financial position and operating results, and terms of significant agreements?

7. Is there a formal process through which the board of directors or audit committee is apprised of sensitive information, investigations and improper acts (e.g., travel expenses of senior officers, significant litigation, investigations of regulatory agencies, defalcations, embezzlement or misuse of corporate assets, violations of insider trading rules, political payments, illegal payments) sufficiently and in a timely manner?

An active and effective board of directors, or underlying committee, provides an important oversight function. In addition, because of management’s ability to override system controls, the board of directors plays an important role in ensuring effective internal control, setting the “tone at the top” and setting other management standards that may affect the risk analysis for the company’s activities. Key components include:

1. Independence from management such that, when necessary, difficult and probing questions are raised. For example, consider:
   a. Whether the board of directors constructively challenges management’s planned decisions (e.g., strategic initiatives and major transactions) and probes for explanations of past results (e.g., budget variances).
   b. Whether a board of directors that consists solely of an entity’s officers and employees (e.g., a small corporation) questions and scrutinizes activities, presents alternative views and takes appropriate action if necessary.
   c. The leadership structure of the board. Have there been changes during the exam period? Has the company chosen to combine or separate the principal executive officer from the Chairman of the Board? Why or why not?
   d. If there is a lead independent director. What role does that person play in the leadership of the company?
   e. If there are any other arrangements intended to ensure that, when necessary, difficult and probing questions are raised with or considered by management. If so, what are they?

2. The use of board committees, where warranted, by the need for more in-depth or directed attention to particular matters. For example, consider whether:
   a. Board committees exist.
   b. They are sufficient, in subject matter and membership, to deal with important issues adequately.

3. The knowledge, integrity and experience of directors. For example, consider:
   a. Whether directors have sufficient knowledge, applicable industry experience and time to serve effectively.
   b. Whether directors have demonstrated integrity through their business conduct.
SECTION 4 – EXAMINATION EXHIBITS

Exhibit M

i. A review of biographical data and background checks performed on directors may provide evidence of appropriate background, integrity and experience from the company licensing process, Insurance Holding Company System Regulatory Act (§440) filings, SEC filings, exam planning questionnaires, additional information gathered as a result of the risk-focused surveillance framework, etc.

   c. Changes in board composition during the examination period, including those that have broadened the experience of the directors as a whole.

   d. The criteria for identifying board of director candidates.

4. The frequency and timeliness with which meetings are held with chief financial and/or accounting officers, internal auditors and external auditors. For example, consider whether:
   a. The audit committee meets privately with the chief accounting officer and internal and external auditors to discuss the reasonableness of the financial reporting process, system of internal control, significant comments and recommendations, and management’s performance.
   b. The audit committee reviews the scope of activities of the internal and external auditors annually.

5. The sufficiency and timeliness with which information is provided to the board of directors or committee members, to allow monitoring of management’s objectives and strategies, the entity’s financial position and operating results, and terms of significant agreements. For example, consider whether:
   a. The board of directors regularly receives key financial information, such as company financial statements and related analysis, the financial results of significant affiliates and business partners and changes to significant contracts.
   b. The board of directors regularly receives key information on strategic risk areas, such as investment strategies and results, reinsurance strategies and results, major marketing initiatives, results of negotiations and information on reasonably foreseeable prospective risks.
   c. The board of directors regularly receives key information on the actuarial function of the organization, such as reports and presentations on the adequacy of reserve provisions, the effectiveness of internal controls, and the prospective solvency position of the insurer.
   d. Directors believe they receive the proper information in a timely and effective manner.

6. The oversight in determining the compensation of executive officers and head of internal audit, and the appointment and termination of those individuals. Smaller or non-public companies are less likely to have the types of compensation policies and practices of larger, publicly traded companies, so the examination should take that fact into consideration. Some examples to consider may include:
   a. Whether the compensation committee, or board, approves executives’ incentive compensation plans.
   b. The general design philosophy of compensation and incentive programs.
   c. Whether the board or compensation committee considers how to eliminate, reduce, or manage material adverse risks to the company that may arise from compensation practices.
   d. Whether there have been any changes in executive compensation plans during the exam period. Review applicable SEC filings and the NAIC Supplemental Compensation Exhibit.
   e. The nature and extent of services provided by compensation consultants during the exam period. Are all services approved by the board of directors or compensation committee? How are independent compensation consultants selected and to whom do they report?
   f. How are management compensation programs reviewed for effectiveness?
   g. What is the process by which changes in compensation programs are approved?
   h. Does the compensation policy induce excessive or inappropriate risk-taking?
   i. Is the compensation policy in line with the identified risk appetite and long-term interests of the insurer with proper regard to the interests of the stakeholders?

7. The board’s role in establishing the appropriate “tone at the top.” For example, consider whether:
   a. The board and audit committee are involved sufficiently in evaluating the effectiveness of the “tone at the top.”
   b. The board of directors takes steps to ensure an appropriate tone.
   c. The board of directors specifically addresses management’s adherence to the code of conduct.
d. The board of directors has developed an adequate conflict of interest policy for officers, management and key personnel.

8. The actions that the board of directors or committee takes as a result of its findings, including special investigations, as needed. For example, consider whether:
   a. The board of directors has issued directives to management detailing specific actions to be taken.
   b. The board of directors oversees and follows up as needed.

B. UNDERSTANDING THE ORGANIZATIONAL STRUCTURE

The organizational structure should not be so simple that it cannot adequately monitor the enterprise’s activities, nor so complex that it inhibits the necessary flow of information. Executives should fully understand their control responsibilities and possess the requisite experience and levels of knowledge commensurate with their positions. Key components include:

1. The appropriateness of the entity’s organizational structure, and its ability to provide the necessary information flow to manage its activities. For example, consider whether:
   a. The organizational structure is appropriately centralized or decentralized, given the nature of the entity’s operations.
   b. The structure facilitates the flow of information upstream, downstream and across all business activities.
   c. Checks and balances exist and are working as intended, allowing for flexibility and responsiveness in the timeliness of decision-making, transparency and concentration of power within the organization.
   d. For insurance groups, consider if group-wide governance policies address risks and objectives at the legal entity level and at the group level.

2. The adequacy of the definition of key managers’ responsibilities, and their understanding of these responsibilities. For example, consider whether:
   a. Responsibilities and expectations for the entity’s business activities are communicated clearly to the executives in charge of those activities.

3. The adequacy of knowledge and experience of key managers in light of responsibilities. For example, consider whether:
   a. The executives in charge have the required knowledge, experience and training to perform their duties.
   b. Key managers understand their responsibilities regarding the insurer’s risk policies/appetites and internal controls.

4. The appropriateness of reporting relationships. For example, consider whether:
   a. Established reporting relationships—formal or informal, direct or indirect—are effective and provide managers with information appropriate to their responsibilities and authority.
   b. The management of the business activities has access to senior operating executives through clear communication channels. The internal audit function reports directly to the board of directors or to the audit committee.

5. The extent to which modifications to the organizational structure and business strategy are made or planned in light of changing conditions. For example, consider whether:
   a. Management periodically evaluates the entity’s organizational structure in light of changes in the business or industry.
   b. For large insurance groups with significant affiliate relationships and interconnectivity (including systemically important financial institutions as designated by the Financial Stability Oversight Council), the board and management is involved in developing and reviewing resolution/contingency plans to be implemented in the event of company failure.
6. Sufficiency in the number of employees, particularly in management and supervisory capacities. For example, consider whether:
   a. Managers and supervisors have sufficient time to carry out their responsibilities effectively.
   b. Managers and supervisors work excessive overtime and/or are fulfilling the responsibilities of more than one employee.
   c. The insurer has succession plans established to replace/retain key employees.

7. The extent of accountability maintained for material activities or functions outsourced to an external party. For example, consider whether:
   a. Outsourced activities and functions are subject to periodic reviews by the insurer or an independent third party.
   b. Outsourced activities and functions are subject to the same degree of accountability as non-outsourced activities and functions.

C. UNDERSTANDING THE ASSIGNMENT OF AUTHORITY AND RESPONSIBILITY

The assignment of responsibility, delegation of authority and establishment of related policies provide a basis for accountability and control, and set forth individuals’ respective roles. Key components include:

1. The assignment of responsibility and delegation of authority to deal with organizational goals and objectives, operating functions and regulatory requirements, including responsibility for information systems and authorizations for changes. For example, consider whether:
   a. Authority and responsibility are assigned to employees throughout the entity.
   b. Responsibility for decisions is related to assignment of authority and responsibility.
   c. Proper information is considered in determining the level of authority and scope of responsibility assigned to an individual.

2. The appropriateness of control-related standards and procedures, including employee job descriptions. For example, consider whether:
   a. Job descriptions, for at least management and supervisory personnel, exist.
   b. The job descriptions, or other standards and procedures, contain specific references to control-related responsibilities.

3. The appropriateness of staff size, particularly with respect to information systems, actuarial and accounting functions, with the requisite skill levels relative to the size of the entity and nature and complexity of activities and systems. For example, consider whether:
   a. The entity has an adequate workforce—in numbers and experience—to carry out its mission.

4. The appropriateness of delegated authority in relation to assigned responsibilities. For example, consider whether:
   a. There is an appropriate balance between authority needed to “get the job done” and the involvement of senior personnel where needed.
   b. Employees at the appropriate level are empowered to correct problems or implement improvements, and empowerment is accompanied by appropriate levels of competence and clear boundaries of authority.

D. ASSESSING MANAGEMENT

A quality assessment of management may be determined through discussions and observations of the governance processes. This assessment should cover both the suitability of individual members of management as well as the suitability, policies and practices of management as a whole. As a general guideline, the following areas should be included in the assessment of management suitability.

1. Do key members of management appear to be suitable for their respective roles? Do they appear to possess the necessary competence and integrity for their positions? Any concerns identified as a result of the assessment of
suitability of individual members of management and management as a whole, should be documented and communicated as appropriate.

2. How long has key management been with the company in their current positions, and what specific industry experience do they have?

3. Has there been significant turnover in management?

4. Have members of management ever been officers, directors, trustees, key employees or controlling stockholders of an insurance company that, while they occupied any such position or served in any such capacity with respect to it:
   a. Became insolvent or was placed in conservation?
   b. Was placed into supervision or rehabilitation?
   c. Was enjoined from, or ordered to cease and desist from, violating any securities or insurance law or regulation?
   d. Suffered the suspension or revocation of its certificate of authority or license to do business in any state?

In addition to the assessment of management suitability, examiners should make an assessment of management’s performance. The following areas should be considered when assessing management performance.

1. Does management periodically review information to adequately assess the impact of changes in competition, technology, regulation, environment and general economic trends that may impact the company’s business?

2. Does management have adequate financial and operating information to identify trends or variations from budgets that may impact the statutory financial statements?

3. Does management effectively analyze and investigate financial and operating information and trends such that significant adverse trends or misstatements in the annual financial statement could reasonably be expected to be identified and rectified on a timely basis?

4. Do management, supervisors and agents have appropriate knowledge and experience to capably and effectively administer management’s policies and procedures?

5. Does the company maintain effective controls to ensure that potential short-term liquidity problems, long-term capital needs and other significant fund management variations/needs are identified and rectified on a timely basis?

6. Do adequate physical safeguards exist over company assets, and are all officers and their employees appropriately bonded? (See Exhibit R – Suggested Minimum Amounts of Fidelity Insurance for assistance.)

7. Does management have a positive attitude toward internal controls (including controls over the information systems)?

8. Does management have adequate financial and operating information to identify, on a timely basis, potential liabilities, commitments and/or contingencies that may require recording and/or disclosure in the annual financial statement?

9. Does management regularly obtain and review key information on strategic risks, including investment strategies and results, reserving methodologies and results, reinsurance strategies and results, and information on reasonably foreseeable prospective risks?
As an expansion of the sample evaluative guidance above, the philosophy and operating style of management will normally have a pervasive effect on an entity. These are intangibles, but one can look for positive and negative signs. Key components include:

1. The nature of business risks accepted (e.g., whether management often enters into particularly high-risk ventures or is extremely conservative in accepting risks). For example, consider whether:
   a. Management moves carefully, proceeding only after carefully analyzing the risks and potential benefits of a venture.

2. Personnel turnover in key functions (e.g., operating, actuarial, accounting, information systems, internal audit). For example, consider whether:
   a. There has been excessive turnover of management and supervisory personnel.
   b. Key personnel have quit unexpectedly or on short notice.
   c. There is a pattern to turnover (e.g., inability to retain key financial or internal audit executives) that may be an indicator of the emphasis that management places on control.

3. Management’s attitude toward the information systems and accounting functions, and concerns about the reliability of financial reporting and safeguarding of assets. For example, consider whether:
   a. The accounting function is viewed as a necessary group of checks and balances, or as a vehicle for exercising control over the entity’s various activities.
   b. The selection of accounting principles used in financial statements always results in the highest reported income.
   c. Operating unit accounting personnel also have the responsibility to report to or communicate with central financial officers.
   d. Valuable assets, including intellectual assets and information, are protected from unauthorized access or use.

4. Frequency of interaction between senior management and operating management, particularly when operating from geographically removed locations. For example, consider whether:
   a. Senior managers frequently visit subsidiary or divisional operations.
   b. Group or divisional management meetings are held frequently.

5. Attitudes and actions toward financial reporting, including disputes over the application of accounting treatments (e.g., selection of conservative vs. liberal accounting policies; whether accounting principles have been misapplied, important financial information not disclosed, or records manipulated or falsified). For example, consider whether:
   a. Management avoids obsessive focus on short-term reported results.
   b. Personnel do not submit inappropriate reports to meet targets.
   c. Managers do not ignore signs of inappropriate practices.
   d. Estimates do not stretch facts to the edge of reasonableness and beyond.

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

1. Are individuals within the insurer’s actuarial function suitable for their respective roles? Do they possess the necessary competence and integrity for their positions?
   a. Does the insurer’s appointed actuary maintain an Accepted Actuarial Designation (Property/Casualty [P/C]) or current actuarial credentials with an appropriate professional organization (e.g., MAAA, etc.) and otherwise meet the definition of a Qualified Actuary, as stated in the NAIC Statement of Actuarial Opinion Instructions?
b. If the company has an internal actuarial function, is it appropriate for the company’s size, complexity, and lines of business written?
   i. Do those within the company’s actuarial function have the appropriate knowledge, experience and background to function in the roles assigned to them?
   ii. Does the organizational chart indicate appropriate lines of reporting for the actuarial function?

c. If the company outsources any part of its actuarial function, is it appropriate for the company’s size, complexity, and lines of business written?
   i. Has management determined that the actuary has the appropriate knowledge, experience and background to function in the assigned role?
   ii. What oversight is the company performing, and who at the company is responsible for this task?

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

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

E. REVIEWING THE RISK MANAGEMENT FUNCTION

A review of the entity’s risk management function should be conducted through discussions with senior management and the board of directors and through gaining an understanding of the risk management function including inspection of relevant risk management documentation. The ORSA guidance outlined in Section 1, Part XI of this Handbook includes procedures, which may assist the examiner in conducting a robust review of the company’s risk management practices and policies. While each of the key principles can be applicable to all insurers, it is important to consider variations in size and complexity and alter expectations appropriately. As a general guideline, the following areas should be considered in conducting a review of the risk-management function:

1. Risk Culture and Governance
   a. What kind of risk-management culture is demonstrated throughout the organization? What does the culture indicate regarding the importance of risk management to the organization?

2. Risk Identification and Prioritization
   a. How are existing risks identified, monitored, evaluated and responded to? Does risk assessment take probability, potential impact and time duration into account?
   b. How are emerging and/or prospective risks identified, monitored, evaluated and responded to?

3. Risk Appetite, Tolerances and Limits
a. How are risk tolerances, appetites and limits defined and communicated throughout the organization? Does the insurer maintain appropriate policies outlining specific obligations of employees in dealing with risk?

b. How does the organization use the risk information it gathers to determine its capital needs?

4. Risk Management and Controls
   a. How are responsibilities for risk-management functions delegated and monitored within the organization?

5. Risk Reporting and Communication
   a. What is the involvement of the board of directors in the risk-management function of the organization?

An effective risk-management function is essential in providing effective corporate governance over financial solvency. During the latter phases of the risk-focused examination, the examiner will document a review of the entity’s individual risk-management functions within the system. However, during a review of the entity’s corporate governance, the examiner should document the review of the entity’s risk-management function as a whole, as well as its place and importance in the entity’s corporate governance structure. For ORSA companies, the knowledge gained in performing a review and assessment of enterprise risk management (ERM) may also be utilized to gain efficiencies, if appropriate, in accordance with the insurer’s assessed maturity level, in the latter phases of the risk-focused examination as described in Section 1, Part XI of this Handbook.

F. CONSIDERATIONS FOR EXAMINATIONS OF INTERNATIONALLY ACTIVE INSURANCE GROUPS

This section identifies additional corporate governance requirements applicable to Internationally Active Insurance Groups (IAIGs). As noted above, when conducting coordinated group exams, the level at which the governance is evaluated may vary. However, if the holding company group under examination has been identified as an IAIG, governance practices must be evaluated at the Head of the IAIG to ensure that appropriate policies and processes are in place to promote effective oversight of the group-wide operations and a sound risk culture. For additional guidance related to the examination of IAIGs, refer to Section 1, Part I in this Handbook.

1. IAIG Board of Directors
   a. Do board members (individually and collectively) and other key individuals (senior management, key persons in control functions, etc.) have the necessary competence to fulfill their role?

   b. Does the board of directors have access to information and processes in place to understand the group’s corporate governance framework and corporate structure; activities of the legal entities and associated risks; supervisory regimes applicable to the IAIG; issues that arise from cross-border business and international transactions; and the risk management, compliance, audit, actuarial and related areas of the group?

   c. Has the board of directors developed an adequate conflict of interest policy for officers, management and key personnel that includes processes to identify and avoid, or manage, conflicts of interest that may adversely affect the IAIG as a whole or any of its legal entities?

   d. Does the board of directors provide appropriate oversight of the group’s internal control and internal audit functions?

   e. Does the board of directors receive relevant information regarding the group’s actuarial function annually on the following topics:
      i. Prospective actuarial analysis of the financial condition of the IAIG
      ii. the reliability and sufficiency of technical provisions (reserves)
      iii. the adequacy of reinsurance credit for technical provisions (reserves)
      iv. consideration of non-insurance legal entities and nonregulated legal entities, if applicable
The examination team should document its understanding and assessment of the entity’s governance, as well as its assessment on the related impact on the examination. This summary should include a description of any unique examination procedures, including special inquiries that are considered necessary to any significant risks identified as a result of the assessment.

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

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

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

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

Examiners should consider the size and complexity of the organization in determining which individuals to interview. The interview process is a key step in the “top–down” approach, beginning with senior management and then drilling down through the various levels of management to obtain a thorough understanding of the organization to assist in scoping the examination. In order to select the individuals to interview, the examiners should obtain an organizational chart from the company and compile a list of potential interviewees. Interviews of board members and senior company management should be conducted by examiners who possess the appropriate background and training. The examiner should also carefully consider the order of interviews, as information gleaned from certain “C”-level individuals can inform subsequent interviews. For example, the Chief Risk Officer (CRO) is uniquely positioned to have an awareness of the various risks facing the company from multiple perspectives. The information obtained through an interview with the CRO can help the examiner have a greater understanding of the key risk areas of the company, which can then be used to further customize subsequent interviews, as well as determine which additional members of management should be interviewed. While it can be challenging to coordinate the interview schedule with company personnel at this level, examiners are encouraged to attempt interviewing the CRO as early in the interview process as possible.

If the company under examination belongs to a holding company group that has been identified as an Internationally Active Insurance Group (IAIG), the group-wide supervisor should consider conducting additional interviews at the Head of the IAIG, including key members of management and the board of directors. Such interviews would assist the group-wide supervisor in determining the consistency of governance practices across the IAIG as well as whether the group’s risk management framework encompasses the Head of the IAIG and legal entities within the IAIG.

Interviews should be performed in person, if possible. This allows the interviewer to receive both verbal and nonverbal communication. The interviews should be kept confidential when possible; however, if a significant fraud or other pertinent issue was discovered through the interviews, the regulator has a duty to report the conflict to the appropriate officials.

The examiner should conduct the interview in a location where both parties are free to talk openly. The examiner should ask relevant questions, with the most general questions posed first as building blocks for additional conversation. The examiner may want to consider alternating between open-ended questions (e.g., “Explain to me how this process works.”) vs. closed-ended questions (e.g., “How many claim processors do you have in your department?”) to obtain the information. Open-ended questions are generally better suited for explanation and processes, while closed-ended questions are better suited to obtain concise information. The examiner should be prepared, listen carefully and focus on the speaker’s entire message, as well as the non-verbal cues expressed during the interview process.
Significant risks and concerns identified through completion of the examination interviews should be adequately addressed within the examination workpapers. As such, all significant risks identified by the examiner during the interview process should be recorded in a central location for tracking purposes, such as Exhibit CC – Issue/Risk Tracking Template or a similar document.

Because information obtained from the interview serves as important evidence in the examination process, the examiner should develop techniques to plan, conduct, document and consider interview information. Although interviews play a key role in gaining useful insight into company operations, interviews alone are not sufficient exam evidence and should be corroborated with other exam documentation to evaluate the accuracy of the information.
NOTE: The following template was prepared to assist examiners in obtaining a general knowledge of the company through the interview process. The examiner performing the interview should not rely exclusively on this template and should tailor questions based on knowledge of the company and the interviewee. Each section of the template is described below to assist the examiner in tailoring the template to the interviewee.

**Instructions**

**Experience and Background** – In this section, the examiner should determine the knowledge, education and practical experience the interviewee possesses. When obtaining background information on board/committee members, the examiner should consider whether the interviewee is independent of the company. If the examiner has obtained sufficient information from the interviewee’s biography, questioning may not be necessary.

**Duties and Responsibilities** – In this section, the examiner should obtain information about what responsibilities the interviewee has within the organization, including any potential conflicting duties. When interviewing board/committee members, the examiner should determine whether the interviewee demonstrates a proper understanding of how management establishes and monitors achievement of objectives. In addition, board members should be able to explain what types of company information they monitor on a continuing basis.

**Reporting Structure** – In the reporting section, the examiner should gain an understanding of the organizational structure and how the interviewee’s department interrelates with other departments. Examiners should obtain information on who reports to the interviewee, as well as to whom the interviewee reports, what type of information is reported and reviewed, and how often the information is reported and reviewed.

**Ethics** – In the ethics section, the examiner should obtain information explaining how ethics are communicated and expressed throughout the company. The examiner also should determine if the interviewee is aware of any fraudulent activities or allegations of fraudulent activities impacting the company. When interviewing board members, the examiner should determine whether the board is reviewing and enforcing the code of conduct on a continuing basis.

**Risk Areas** – In this section, the examiner should ask the interviewee to explain the risks inherent in his/her department or area of interest. Inquiring about risks will assist the examiner in completing Phase 2, Identify and Assess Inherent Risk in Activities. In addition to interviewing board members and upper management about risks inherent to the company, the examiner should also obtain information regarding types of external/environmental factors affecting the company.

**Risk Mitigation Strategies** – In this section, the examiner should ask the interviewee to explain how the company mitigates risks identified in the previous section. This information should include what types of controls are in place to prevent or detect those risks. Inquiring about risk mitigation strategies will assist the examiner in Phase 3, Identify and Evaluate Risk Mitigation Strategies (Controls).

**Corporate Strategy** – This section only pertains to board/committee members and upper management. The examiner should ask the interviewee to explain the corporate strategic initiatives of the company. In addition, the examiner should determine how the company prepares strategic plans for the future of the company and what competitive advantages/disadvantages exist within the company.

**Other Topics** – In this section, the examiner should obtain information regarding any other topics not previously discussed. Some topics include significant turnover in the interviewee’s department, political or regulatory changes that may affect business and prospective risks.

**Conclusion** - In this section, the examiner should document any concerns related to the suitability of the individual members of management for their assigned roles and responsibilities.
NOTE: The following lists of questions represent optional tools for examiners to use when conducting examination interviews. Lists have been created for several key positions of the company that are commonly interviewed during the examination process. Each list includes questions that have been customized based on the company position that examiners may consider asking during the interview. It is important to note that the actual questions asked during the examination interview process should be at the discretion of the interviewer. **Not all questions included in the listing may be appropriate for each interview. In addition, the interviewer should ask questions not included in the listing, according to the examiner’s understanding of the company.**
Experience and Background

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

Duties and Responsibilities

- How often does the board/committee meet? Why is that sufficient?
- Briefly describe your duties and responsibilities, including what types of company information you monitor on a continuous basis.
- How does management establish objectives and how does the board of directors monitor achievement of those objectives?
- What role does the board of directors play in determining executive compensation?
- What areas are discussed and what type of decisions are made by the board/committee?
  - How does the board ensure that sufficient information is received to make informed decisions on behalf of the company?
- Does the board/committee review related-party transactions?
- What role does the board/committee play in overseeing the actuarial function as well as associated internal controls?

Reporting Structure

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

Ethics

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

Risk Areas

- How does the board identify and monitor key risks faced by the company?
  - What are the key risks the board has identified?
  - What are the key prospective risks the company faces?
- Does the board review any type of stress testing?

Risk Mitigation Strategies (Internal Controls)

- How often does the board receive reports from management on the internal controls of the company?
  - What information is reported?

Corporate Strategy

- How is the board involved in significant corporate strategy decisions?
- Does the board approve an annual business plan?
- How does the board gain comfort with total exposures and the risk/return trade-offs?
- Where is the company headed strategically? What type of plan is in place to implement this strategy? Has it been approved? How is it being monitored?
- Is the corporate strategy effectively communicated between senior management and the rest of the company?
- Explain any strengths or weaknesses of the company, as well as opportunities or threats, the company is facing and how the company is responding to each.
• If part of a holding company:
  - How does the holding company contribute to the company’s strategy?
  - How might the holding company be impacted by the company’s strategy?

Other Topics
• Explain any significant turnover in senior management or on the board/committee.
• What type of succession planning does the company have in place?
• Based on the current economic climate, are there any other competencies/skills that would be useful to the board?
• Is the current size of the board sufficient to fulfill necessary oversight responsibilities?
• How does the company monitor and assess financing needs, as well as access to capital?
• How does the company monitor, assess and respond to information security risks (including those related to cybersecurity threats)?
Sample Interview Questions for the Chief Executive Officer

Experience and Background
- How has your professional experience and background prepared you to serve as the Chief Executive Officer for this company?

Duties and Responsibilities
- Briefly describe your duties and responsibilities.
- How does management establish objectives and how is the achievement of those objectives monitored?
- What role do you play in the hiring of senior management and determining executive compensation?
  - How is your compensation determined?
- How do you support the operations and administration of the board?
- Briefly describe your oversight responsibilities regarding the company’s actuarial function?

Reporting Structure
- Describe the reporting structure of the company, including to whom you report, as well as those reporting to you.
- Explain the function and reporting structure of your senior management team.
  - How often are you in contact with them?
- Describe your interaction with the board of directors.

Ethics
- Does the company have a code of conduct/ethics in place? Is it enforced? Approved?
- Explain management’s commitment to ethics and explain how management conveys that commitment to employees.
  - How does management obtain an understanding of the “tone” throughout the organization?
- When establishing ethics, does the company evaluate what other companies have implemented? If yes, how does the company compare?
- Do you have any knowledge or suspicion of fraud within the company?

Risk Areas
- How are key risks faced by the company identified and monitored?
  - What are the key prospective risks the company faces?
  - How are these risks communicated to senior management and throughout the company?
- Describe any stress testing performed by the company.

Risk Mitigation Strategies (Internal Controls)
- What is the formal procedure for reporting on risk management to senior management and the board?
- Explain your commitment to the internal control structure.
- What is your company’s plan for operating in crisis/disaster – business continuity?
- From a strategic perspective, how are risks addressed across all business units and entities?

Corporate Strategy
- Where is the company headed strategically? What type of plan is in place to implement this strategy? Has it been approved? How is it being monitored?
- What are your plans for retaining and growing business?
- Explain what types of tools and/or reports you utilize to make key business decisions.
- Explain any strengths or weaknesses of the company, as well as opportunities or threats, the company is facing and how the company is responding to each.
- What key measures do you assess to evaluate the company’s performance and competitive position?
- If part of a holding company:
  - How does the holding company contribute to the company’s strategy?
  - How might the holding company be impacted by the company’s strategy?
• How often do you discuss corporate strategy with your direct reports?

Other Topics
• Explain any significant turnover in senior management and/or on the board/committee.
• What type of succession planning does the company have in place?
• How does the company monitor and assess financing needs, as well as access to capital?
• How does the company monitor, assess and respond to information security risks (including those related to cybersecurity threats)?
Experience and Background
- How has your professional experience and background prepared you to serve as Chief Financial Officer for this company?

Duties and Responsibilities
- Briefly describe your duties and responsibilities, including the preparation and information flow of financial reports.
- How does management establish objectives and how is the achievement of those objectives monitored?
- How is your performance evaluated? Is it based on the performance of the company?
- Describe your involvement in regulatory compliance.

Reporting Structure
- Describe the reporting structure of the company, including to whom you report, as well as those reporting to you.
- Describe your interaction with the board of directors, as well as internal/external auditors.
- How is financial information disclosed to the board/shareholders/creditors/others?

Ethics
- Does the company have a code of conduct/ethics in place? Is it enforced? Approved?
- Explain management’s commitment to ethics and explain how management conveys that commitment to employees.
  - How does management obtain an understanding of the “tone” throughout the organization?
- When establishing ethics, does the company evaluate what other companies have implemented? If yes, how does the company compare?
- Do you have any knowledge or suspicion of fraud within the company?
- Have you ever had to take a position on an accounting/reporting issue or make an adjustment to the financial statements that you were uncomfortable with or did not fully understand?

Risk Areas
- How are key risks faced by the company identified and monitored?
  - What are the key prospective risks the company faces?
  - How are these risks communicated to your senior management level team and throughout the company?
- What key risks do you monitor in your position?
  - What reports or other means do you utilize to evaluate the risks?
- Do you monitor risks relevant to specific components or divisions within the entity?

Risk Mitigation Strategies (Internal Controls)
- How often do you discuss with the audit committee/board of directors how the internal control system serves the company?
- How has the NAIC Annual Financial Reporting Model Regulation (Model Audit Rule) affected the company and/or the holding company?
- Briefly describe the key aspects of the financial reporting process, including validation of financial information, review and approval, and distribution.
- Describe some of the key management estimates (e.g., loss reserves, etc.) included within the company’s financial reports and describe how they are performed, reviewed and approved.
- Describe the budgeting and planning process.
- Briefly describe the month/year-end close process, including manual journal entries and approvals.
- What is the process for adopting/implementing accounting guidance?
Corporate Strategy
- Where is the company headed strategically? What type of plan is in place to implement this strategy? Has it been approved? How is it being monitored?
- What are your plans for retaining and growing business?
- Explain what types of tools and/or reports you utilize to make key business decisions.
- How do you identify and manage changes in business conditions?
- Explain any strengths or weaknesses of the company, as well as opportunities or threats, the company is facing and how the company is responding to each.
- What key measures do you assess to evaluate the company’s performance and competitive position?
- If part of a holding company:
  - How does the holding company contribute to the company’s strategy?
  - How might the holding company be impacted by the company’s strategy?
- How often do you discuss corporate strategy with your direct reports?

Other Topics
- Explain any significant turnover in your department.
- How are related-party transactions approved and recorded, and how are related-party transactions disclosed to shareholders?
- Is the accounting department adequately staffed?
- How does the company monitor and assess financing needs, as well as access to capital?
- Explain the company’s involvement in transactions that include derivative risks.
- Is the company subject to any derivative risks that are not disclosed within Schedule DB of the Annual Statement? If so, please explain.
Sample Interview Questions for the **Chief Operating Officer**

**Note:** Several different functions/processes could report to the chief operating officer. Some of these areas have questions outlined within this exhibit (e.g., underwriter, actuary, etc.) The examiner will likely need to tailor interview questions for other specific functions that are not included (e.g., claims handling, sales and marketing, human resources, etc.).

**Experience and Background**
- How has your professional experience and background prepared you to serve as the Chief Operating Officer for this company?

**Duties and Responsibilities**
- Briefly describe your duties and responsibilities.
- How does management establish objectives and how is the achievement of those objectives monitored?
- How is your performance evaluated? Is it based on the performance of the company?
- Describe your involvement in regulatory compliance.
- Describe your involvement in the sales and marketing aspects of the company.

**Reporting Structure**
- Describe the reporting structure of the company, including to whom you report, as well as those reporting to you.
- Describe your interaction with the CEO and other senior management, as well as the board of directors.

**Ethics**
- Does your company have a code of conduct/ethics in place? Is it enforced? Approved?
- Explain management’s commitment to ethics and explain how management conveys that commitment to employees.
- When establishing ethics, does the company evaluate what other companies have implemented? If yes, how does the company compare?
- Do you have any knowledge or suspicion of fraud within the company?

**Risk Areas**
- How are key risks faced by the company identified and monitored?
  - What are the key prospective risks the company faces?
  - How are these risks communicated to senior management and throughout the company?
- What key risks do you monitor in your position?
  - What reports or other means do you utilize to evaluate the risks?
- Do you monitor risks relevant to specific components or divisions within the entity?

**Risk Mitigation Strategies (Internal Controls)**
- How often do you discuss with the audit committee/board of directors how the internal control system serves the company?
- How has the NAIC *Annual Financial Reporting Model Regulation* (Model Audit Rule) affected the company and/or the holding company?
- What internal controls are in place to mitigate risks in the processes you supervise?

**Corporate Strategy**
- Where is the company headed strategically? What type of plan is in place to implement this strategy? How does the strategy impact activities within your department?
- Explain strengths or weaknesses of the company, as well as opportunities and threats the company is facing, and how the company is responding to each.
- What are your plans for retaining and growing business?
- What key measures do you assess to evaluate the company’s performance and competitive position?
- How often do you discuss corporate strategy with your direct reports?
Other Topics

- Explain any significant turnover in your department.
- How do you ensure that your department is adequately staffed?
- How often are claims reviews or audits performed and by whom? What are examples of items that would be reviewed during the audit?
Sample Interview Questions for an Internal Auditor

Experience and Background
- How has your experience and background prepared you to serve as an internal auditor for this company?

Duties and Responsibilities
- Briefly describe your duties and responsibilities.
- How is your performance evaluated? Is it based on the performance of the company?
- How much of your department’s time is allocated to the NAIC Annual Financial Reporting Model Regulation (Model Audit Rule) process, business process reviews, compliance?
- Do you perform any management, operational, risk management or accounting functions?
- What is the role of the internal audit function in verifying the effectiveness of risk management processes?
- How are audit findings communicated to the company and the board/audit committee?
- Please describe any special projects and/or key initiatives.

Reporting Structure
- Describe the reporting structure of the company, including to whom you report, as well as who reports to you.
- Describe your interaction with the board of directors/audit committee, external auditors and/or senior management.
- How do you monitor/follow up on audit findings? Are findings classified as to significance?

Ethics
- Does the company have a code of conduct/ethics in place? Is it enforced? Approved?
- Explain your commitment to ethics and explain how you convey that commitment to your employees.
- How does the company compare to others in terms of its position on ethics?
- Do you have any knowledge or suspicion of fraud within the company?

Risk Areas
- How are key risks faced by the company identified and monitored?
  - What are the key prospective risks the company faces?
  - How are these risks communicated to senior management and throughout the company?
- What key risks do you monitor in your position?
  - What reports or other means do you utilize to evaluate the risks?
- Do you monitor risks relevant to specific components or divisions within the entity?
- How do you determine which audits to perform and the appropriate scope for those audits?

Risk Mitigation Strategies (Internal Controls)
- How does the internal audit department address the potential for override of internal controls?
- Do you discuss with the audit committee/board of directors how the internal control system serves the company? How often?
- How has the NAIC Annual Financial Reporting Model Regulation (Model Audit Rule) affected the company, if at all? How has it affected the holding company and/or the internal audit department?
- Describe any internal control issues discussed during the most recent audits.
- Do you review the company’s application of accounting guidance?

Corporate Strategy
- Explain strengths or weaknesses of the company, as well as opportunities and threats the company is facing, and how the company is responding to each.
- What key measures do you assess to evaluate the company’s performance and competitive position?
- If part of a holding company:
  - How does the holding company contribute to the company’s strategy?
  - How might the holding company be impacted by the company’s strategy?
- How often do you discuss corporate strategy with your direct reports?

Other Topics
- Explain any significant turnover in your department.
- How do you ensure the internal audit department is adequately staffed?
- How are internal audit members hired?
- Are any internal audit functions outsourced?
- Is the company involved in transactions that include derivative risks?
- Is the company subject to any derivative risks that are not disclosed within Schedule DB of the Annual Statement?
Experience and Background
- How has your professional experience and background prepared you to manage the investments for this company?

Duties and Responsibilities
- Briefly describe your duties and responsibilities.
- How does management establish investment objectives and how is the achievement of those objectives monitored?
- Describe the governance structure over investments?
- Are there written investment guidelines that the company must follow?
  - Do you or others monitor them for compliance?

Reporting Structure
- Describe the organizational structure of the investment function.
- Describe the reporting structure of the company, including to whom you report, as well as those reporting to you.
- Describe your interaction with the board of directors and the CEO.
- What is the composition and role of the investment committee, and is that committee independent from operational management?
  - How often does the investment committee meet?
  - What are their areas of concern?

Ethics
- Does the company have a code of conduct/ethics in place? Is it enforced? Approved?
- Explain management’s commitment to ethics and explain how management conveys that commitment to employees.
- Do you have any knowledge or suspicion of fraud within the company?

Risk Areas
- What is the company’s risk tolerance for investments and how is that communicated?
- How does the company monitor risks related to investments (e.g., interest rate risk, credit risk, etc.)?
- How does the company review its risk/reward trade-off?
- How does the company determine its asset allocation strategy?
- Does the company consider the impact of climate change risks when determining its investment strategy and/or monitoring the risks in its investment portfolio? If yes, please explain.

Risk Mitigation Strategies (Internal Controls)
- What is the formal procedure for reporting on risk management to senior management and the board?
- What types of internal controls exist to ensure adherence to investment policies and procedures?
- How is performance and compliance gauged (both with statutory rules and internal investment policies)?
- Who monitors potential impairment issues?
  - How often?
- What types of controls and authorizations are in place to transfer money?
  - Are all employees with access to funds bonded?
- Are all transactions approved by senior management?
- How does the company monitor and determine the value for its Schedule BA investments?
- How are assets and liabilities matched at the company?

Corporate Strategy
- Where is the company headed strategically? What type of plan is in place to implement this strategy? How does the strategy impact activities within your department?
• Explain strengths or weaknesses of the company, as well as opportunities and threats the company is facing, and how the company is responding to each.
• Is the company-wide strategy clearly communicated by senior management to the rest of the company?
  - How does that impact your department’s goals/activities?
• Explain what tools or reports you utilize to make key business decisions.

Other Topics
• Explain the company’s involvement in transactions that include derivative risks.
• Is the company subject to any derivative risks that are not disclosed within Schedule DB of the Annual Statement? If so, please explain.
Sample Interview Questions for Internal Legal Counsel

Experience and Background
• How has your professional experience and background prepared you to serve as legal counsel for this company?

Duties and Responsibilities
• Briefly describe your duties and responsibilities.
• How do you identify any potential legal issues that may arise within the company?

Reporting Structure
• Describe the reporting structure of the company, including to whom you report, as well as who reports to you.

Ethics
• Does the company have a code of conduct/ethics in place? Is it enforced? Approved?
• Explain management’s commitment to ethics and explain how management conveys that commitment to employees.
• Do you have any knowledge or suspicion of fraud within the company?

Risk Areas
• How are key legal and regulatory risks faced by the company identified and monitored?
  - What are the key prospective risks the company faces?
  - How are these risks communicated to senior management and throughout the company?
• Explain any significant (use a predetermined threshold) lawsuits/legal actions outstanding against the company?
• Are the number of lawsuits fluctuating or remaining constant?

Other Topics
• Has there been any turnover in your department?
• Describe your staff’s experience.
• Are any legal functions outsourced? How are those functions monitored?
Sample Interview Questions for Chief Risk Officer

Experience and Background
- How has your professional experience and background prepared you to serve as the Chief Risk Officer for this company?

Duties and Responsibilities
- Briefly describe your duties and responsibilities.
- How does your role/function relate to, or how is it integrated with Sarbanes-Oxley Act and/or NAIC Annual Financial Reporting Model Regulation (Model Audit Rule) processes, internal audit and/or other departments?
- Describe the major projects taking place and how you divide your departments time (i.e., what are the areas of focus)?
- Do you publish reports/findings?
  - To whom are they distributed and how often are they distributed?

Reporting Structure
- Describe the reporting structure of the company, including to whom you report, as well as who reports to you.
- Is there a board-level committee or other group that you report to?
  - Is that group independent from your area of management?
  - What is their role and how do you interact with them?
- Describe those who have been involved (e.g., your team, internal audit, operational areas, consultants, external auditors, etc.) and their roles in the Model Audit Rule compliance process.
- Are there any financial ties to company profits within your compensation package?

Ethics
- Does the company have a code of conduct/ethics in place? Is it enforced? Approved?
- Explain management’s commitment to ethics and explain how management conveys that commitment to employees.
- When establishing ethics, does the company evaluate what other companies have implemented? If yes, how does the company compare?
- Do you have any knowledge or suspicion of fraud within the company?

Risk Areas
- How are key risks faced by the company identified and monitored?
  - What are the key prospective risks the company faces?
  - How are these risks communicated to senior management and throughout the company?
- Do you monitor risks relevant to specific components or divisions within the entity?
- What key risks do you monitor in your position?
  - What reports or other means do you utilize to evaluate the risks?
- Does your company consider the impact of climate change risks as part of its overall risk management practices?
  - If so, what risks have you identified related to the impact of climate change risks?
  - If so, what is done to analyze and mitigate each of those risks? Is this done independently or as part of weather-related risks in general?
- Are you involved in the company’s process for establishing and monitoring reserving risks?
  - If so, please describe the company’s process to establish and monitor reserving risks.

Risk Mitigation Strategies (Internal Controls)
- What is the formal procedure for reporting on risk management to senior management and the board?
- What is the company’s plan for operating in crisis/disaster – business continuity?
- From a strategic perspective, how are risks addressed across all business units and entities?
SECTION 4 – EXAMINATION EXHIBITS

- How has the Model Audit Rule affected the company, if at all? How has it affected the holding company and/or the internal audit department?
- Does the organization structure allow for proper segregation of duties?
- What internal controls exist to ensure adherence to company policies and procedures, as well as regulatory procedures?
- What procedures are in place to diversify risks?
- What strategies are used for managing the most significant risks facing the company?
- Are executive officers and management team members required to disclose personal business or family relationships with organizations in which your company invests?
- Describe any compliance-related training conducted by the organization.
  - Is the training required?
- Are quality reviews performed by internal auditors or other means within the company?
- How are goals set and performance evaluated?
  - How is that linked to responsibility and accountability?
  - How does all of that impact the divisional level?
- What is the nature and extent of incentive compensation throughout the company?
  - How are risks related to compensation identified, monitored and mitigated?

Corporate Strategy
- Explain strengths or weaknesses of the company, as well as opportunities and threats the company is facing, and how the company is responding to each.

Other Topics
- Do you have an organization-wide integrated risk management framework?
- Explain the company’s involvement in transactions that include derivative risks.
- Is the company subject to any derivative risks that are not disclosed within Schedule DB of the Annual Statement? If so, please explain.
Sample Interview Questions for Underwriting

Experience and Background

- How has your professional experience and background prepared you to serve as an underwriter for this company?

Duties and Responsibilities

- Briefly describe your duties and responsibilities.
- Describe the company’s book of business.
  - Program business, treaty, facultative.
  - Mix of property/liability.
  - Mix of excess/quota share.
- Are there written underwriting guidelines that the company must follow?
  - Do you or others monitor them for compliance?
  - Do you have a written best practices checklist that includes quality standards?
- How do you monitor regulatory compliance?
- How do you evaluate your staff?
- Describe how your underwriters’ skill levels are developed.

Reporting Structure

- Describe the reporting structure of the Underwriting Department, including to whom you report, as well as those reporting to you.
- Is there an underwriting committee?
  - How is it organized and who are its members?
- Describe your interaction with the CFO/CEO/BOD.
  - Do you provide them with any specific reports?

Ethics

- Does the company have a code of conduct/ethics in place? Is it enforced? Approved?
- Explain management’s commitment to ethics and explain how that commitment is conveyed to employees.
- Do you have any knowledge or suspicion of fraud within the company?
- Does the company require ethics training for underwriters and brokers?

Risk Areas

- How are key risks faced by the company identified and monitored?
  - What are the key prospective risks the company faces?
  - How are these risks communicated to senior management and throughout the company?
- What key risks do you monitor in your position?
  - What reports or other means do you utilize to evaluate the risks?
- Describe the development and approval process for new products.
- What are the underwriting authorization levels?
- Which lines of business performed well/poorly in the past?
- What percent of your cases are automatically underwritten vs. manually underwritten?
- How do you determine if you are underwriting the cases you should?
- Give a general description of product pricing.

Risk Mitigation Strategies (Internal Controls)

- How does the company ensure that correct contractual language and rates are used?
- What controls are in place to ensure underwriting guidelines are followed?
- How are brokers monitored to ensure compliance with underwriting standards?
- How often are underwriting audits performed and who performs them?
- How do you ensure that what is underwritten gets entered as premium correctly?
- How does the underwriting function fit into the overall corporate strategy?
Do you have a documented procedure for following actual loss to expected loss ratios?
What types of reports do you use to monitor underwriting activity?
How is premium adequacy maintained?

Corporate Strategy
- Where is the company headed strategically? What type of plan is in place to implement this strategy? How does the strategy impact activities within your department?
- Explain strengths or weaknesses of the company, as well as opportunities and threats the company is facing, and how the company is responding to each.
- Explain what tools or reports you utilize to evaluate underwriting decisions.
- What key measures do you assess to evaluate the company’s performance and competitive position?

Other Topics
- Explain any significant turnover in the underwriting department.
- Explain the distribution channels used by the company.
- What is the compensation/commission structure for each distribution channel?
- How do you ensure that your staff is handling an appropriate number of cases?
Sample Interview Questions for the Chief Actuary

Experience and Background
- How has your professional experience and background prepared you to be the Chief Actuary for this company?

Duties and Responsibilities
- Briefly describe your duties and responsibilities.
- How does management establish objectives, and how is the achievement of those objectives monitored?
- How is your performance evaluated? Is it based on the performance of the company?

Reporting Structure
- Describe the reporting structure of the actuarial function, including to whom you report, as well as those reporting to you.
- Is there a reserving committee?
  - How is it organized and who are its members?
  - How are differences resolved?
- Describe your interaction with the CFO/CEO/BOD.
  - Do you provide them with any specific reports?
- Do the board/audit committee members demonstrate an understanding of the variability inherent in the reserves?
- How does the board/committee oversee the application of Principle Based Reserving (if applicable)?

Ethics
- Does the company have a code of conduct/ethics in place? Is it enforced? Approved?
- Explain management’s commitment to ethics and explain how that commitment is conveyed to employees.
- Do you have any knowledge or suspicion of fraud within the company?

Risk Areas
- How are key legal and regulatory risks faced by the company identified and monitored?
  - What are the key prospective risks the company faces?
  - How are these risks communicated to senior management and throughout the company?
- Have there been changes in the appointed actuary in recent years and, if so, how often have such changes occurred and why?
- What is the current reinsurance program? Describe any changes over the past five years.
- Describe the company’s process to establish Principle Based Reserves.
  - Does the company have credible experience or experience studies to substantiate the model assumptions?
  - Does the company use a vendor supplied or internally developed Cash Flow Model?

Risk Mitigation Strategies (Internal Controls)
- What is the formal procedure for reporting on risk management to senior management and the board.
- What controls are in place to ensure reserving guidelines are followed?
- Who determines which reserves will be booked in the financial statements quarterly and/or annually?
- How often are full reserve analyses performed?
- Does the company book to the actuary’s point estimate, or is there a monitored gap?
- Is the actuarial opinion signed by a company actuary or a consultant?
- Does the company use commercial software or “homegrown” spreadsheets? What controls are in place to check for errors?
- How are pricing and underwriting monitoring integrated into the reserving process?
- Is there a peer review of the reserving actuary’s work? If so, who performs it?
- How much reliance does the appointed actuary place on the work of others?
- Describe the controls in place over the PBR processes.
- Has the company instituted any new controls as a result of the implementation of Principle Based Reserving (if applicable)?
• Describe the modeling controls in place supporting the Principle Based Reserving processes (e.g. model validation, changes in modeling assumptions, etc.).
• If the company writes long-term care insurance (LTCI), consider the following questions:
  - Describe how applicable actuarial guidelines (e.g., *Actuarial Guideline LI—The Application of Asset Adequacy Testing to Long-Term Care Insurance Reserves* [AG 51]) affect the company’s rates and reserves.
  - Describe the relationship between the actuarial assumptions used in rate filings versus those used for annual statement reporting. Explain any difference in assumptions, if applicable.
  - Describe the relationship between the actuarial assumptions underlying projections versus those used in asset adequacy analysis. Explain any difference in assumptions, if applicable.
  - Describe plans for future rate increase requests and/or the status of current rate requests.

**Corporate Strategy**
• Give a general description of the company’s reserving philosophy.
• Explain what types of tools or reports you utilize to evaluate actuarial decisions.

**Other Topics**
• What is the quality of the actuarial report, with respect to completeness and clarity of documentation?
• What actions have been taken to apply PBR methodologies? *(Life Insurers Only)*
  - How are system capabilities considered in preparation for PBR implementation?
  - What system changes were made to apply PBR?
  - How are staffing needs, appropriate expertise and availability of effective training evaluated in preparation for PBR implementation?
  - What changes to staffing and training were made to apply PBR?
  - Discuss management’s commitment to successful implementation of PBR.
Sample Interview Questions for a Captive Manager and/or Other Contracted Parties (for Risk Retention Groups)

Experience and Background
- Who are the team members on this account and what are their backgrounds?
- Has there been any turnover since the prior exam?
- How does your experience and background qualify you to oversee this account?
- Are you and your team members independent of the company?

Duties and Responsibilities
- What are your organization’s duties and responsibilities with regard to the RRG? Are these duties and responsibilities identified in a contract? (If so, obtain a copy of the contract.)
- Briefly describe your duties and responsibilities.
- How does management establish objectives and how do you monitor achievement of those objectives?
- What is your level of involvement in managerial decisions specific to this account?
- What is your team’s responsibility in regards to the following areas:
  - Accounting and Financial Reporting
  - Cash Handling
  - Investments
  - Claims
  - Premiums
  - Reinsurance
  - Regulatory Compliance (state, federal, etc.)
  - Other?

Reporting Structure
- Explain the organization and reporting structures of the company.
- Describe your interactions and relationship with company management. How frequent are these interactions?
- How often do you receive reports from management, TPAs or other internal or external sources?
  - What information is reported?
- Have you encountered any issues obtaining information from management, TPAs or other internal or external sources?
- Are there any inconsistencies in information received from the company contact, TPAs or other internal or external sources?

Ethics
- Do the company and management firm both have a code of conduct/ethics in place? How are they enforced?
- Do you have any knowledge or suspicion of fraud within the company?

Risk Areas
- What do you perceive to be the key risks (including prospective) affecting this company?
- How are these key risks monitored?

Corporate Strategy
- Are you aware of any current or future changes that will have an effect on this organization?
Sample Interview Questions for the Chief Marketing Officer

Experience and Background
- How has your professional experience and background prepared you to be the Chief Marketing Officer for this company?

Duties and Responsibilities
- Briefly describe your duties and responsibilities.
- How does management establish objectives, and how is the achievement of those objectives monitored?
- How is your performance evaluated? Is it based on the performance of the company?
- How do you evaluate your staff?

Reporting Structure
- Describe the reporting structure of the marketing function, including to whom you report, as well as those reporting to you.
- Is there a marketing committee?
  - How is it organized and who are its members?
  - How are differences resolved?
- Describe your interaction with the CFO/CEO/BOD.
  - Do you provide them with any specific reports?

Ethics
- Does the company have a code of conduct/ethics in place? Is it enforced? Approved?
- Explain management’s commitment to ethics and explain how that commitment is conveyed to employees.
- Do you have any knowledge or suspicion of fraud within the company?

Risk Areas
- How are key risks faced by the company identified and monitored?
  - What are the key prospective risks the company faces?
- How are these risks communicated to senior management and throughout the company?
- What is the current marketing strategy? Describe any changes over the past five years.

Risk Mitigation Strategies (Internal Controls)
- What is the formal procedure for reporting on risk management to senior management and the board?

Corporate Strategy
- Give a general description of the company’s marketing philosophy.
- Where is the company headed strategically? What type of plan is in place to implement this strategy? How does the strategy impact activities within your department?
- Explain strengths or weaknesses of the company, as well as opportunities and threats the company is facing, and how the company’s marketing strategy and tactics are responding to each.
- Explain what types of key tools or reports you utilize to evaluate marketing decisions.
- What key measures do you assess to evaluate the company’s performance and competitive position?

Other Topics
- Explain any significant turnover in the marketing department.
- Explain the distribution channels used by the company.
- What is the compensation/commission structure for each distribution channel?