

Financial Examiners Handbook (E) Technical Group Exposure Drafts

The following documents were exposed for a 30-day comment period ending October 23, 2024. These are also available on the “Exposure Drafts” tab of the [Financial Examiners Handbook \(E\) Technical Group page](#). Comments should be directed to Elise Klebba (eklebba@naic.org). Word versions available upon request.

- Executive Compensation Revisions
 - Exhibit V Prospective Risks (Pages 2-7)
 - Exhibit Y Interview Questions (Pages 8 – 9)
- Manual Adjustments to RBC Revisions
 - Capital and Surplus Repository (Pages 10 – 12)

EXHIBIT V – OVERARCHING PROSPECTIVE RISK ASSESSMENT

Background

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

Use of this Exhibit

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

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

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

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

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

The investigation of prospective risks on Exhibit V should be completed by the end of Phase 5. It is not required that the various steps to investigate prospective risks on Exhibit V directly coincide with the seven-

phase exam approach, but it is recommended that examiners complete each step of Exhibit V as early in the exam as practical to ensure each risk identified is sufficiently tested and reviewed.

Exhibit V, Part One – Overarching Prospective Risk Testing Template

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

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

Exhibit V, Part Two – Common Areas of Concern

Exhibit V, Part Two may be used as a reference guide to assist in identifying categories of prospective risk that may be relevant for review and inclusion on the Exhibit V, Part One. Note: examiners are not required to identify a risk from each category listed or provide a rationale for not identifying risks from the common areas of concern.

PART ONE – OVERARCHING PROSPECTIVE RISK TESTING TEMPLATE

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

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Overarching Prospective Risk Identified	Branded Risk	Risk Mitigation Strategies	Investigate Risk Exposure	Risk Assessment Level	Trend	Rationale	Communicate Findings to Financial Analysis
<p><i>Note: Only P/C insurers.</i></p>		<p><i>of directors at the next annual meeting.</i></p>					<p><i>of directors on the impact of climate scenarios on the company's long-term business strategy. In addition, the analyst should request updated medium-term climate scenario results from the company annually to track changes in estimated future exposures.</i></p>
<p><u><i>Example Prospective Risk #5:</i></u></p> <p><u><i>The company's executive compensation plans include incentives based on financial metrics which may</i></u></p>	<p><u><i>OP</i></u></p>	<p><u><i>The Board of Directors reviews and approves executive compensation plans, including any incentive plans. Incentive plans and variable compensation practices are intended to emphasize long-term financial goals and avoid excessive focus on short-term growth and performance.</i></u></p>	<p><u><i>Obtained the board minutes to ensure board review and approval of the executive compensation plan structure, which does not incorporate some long-term goals. However, much of the incentive compensation</i></u></p>	<p><u><i>Moderate</i></u></p>	<p><u><i>Increasing</i></u></p>	<p><u><i>The Company's executive compensation plan has been reviewed and approved by the Board; however, the incentives are largely dependent upon some</i></u></p>	<p><u><i>The analyst should continue to monitor fluctuations in the company's general expenses, as well as the overall expense ratio and profitability to identify potential issues regarding the executive</i></u></p>

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

PART TWO – COMMON AREAS OF CONCERN

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

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

EXHIBIT Y

EXAMINATION INTERVIEWS

Overview

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

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

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

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

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Sample Interview Questions for Board or Committee Members

Experience and Background

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

Duties and Responsibilities

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

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

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

Reporting Structure

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

Ethics

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

Risk Areas

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

EXAMINATION REPOSITORY – CAPITAL AND SURPLUS

Own Risk and Solvency Assessment (ORSA)

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

Annual Statement Blank Line Items

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

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

Relevant Statements of Statutory Accounting Principles (SSAPs)

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

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

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

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Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
and future business operations.				<p>Underlying assets to be considered may include:</p> <ul style="list-style-type: none"> • Deferred tax assets • Significant receivables • Goodwill • Investment in subsidiary • Encumbered assets • Defined benefit pension asset <p>The insurer maintains documentation regarding permitted practices that could impact the quality of available capital and reviews all associated calculations to ensure compliance.</p>	<p>Obtain documentation of the insurer's review of its compliance with permitted practices.</p>	<p>consideration of the liquidity of the assets under review.</p> <p>Review the make-up of the insurer's capital and assess how the categories (e.g., common stock, preferred stock, surplus notes, paid-in-capital, etc.) support the ongoing and future business operations.</p> <p>Review the insurer's calculations to ensure they comply with the permitted practices granted by the domiciliary insurance commissioner. Review the effects of the permitted practice on RBC calculations, including subsequent examination adjustments.</p>
<p>The insurer is not accurately calculating, reporting and monitoring RBC, including any manual adjustments to RBC charges (i.e., Modco Reinsurance, Separate Accounts, etc.).</p>	OP	CM	CMT	<p>RBC calculations are performed in accordance with instructions and subject to supervisory review.</p> <p>The company has a process to ensure that RBC reports and supporting data are filed with the NAIC in a timely and complete manner.</p>	<p>Test controls relating to the insurer's supervisory review process for RBC.</p> <p>Review the NAIC RBC crosscheck letter from the insurer or the NAIC, if applicable, and response letter from the insurer to determine the</p>	<p>Obtain and review the insurer's supporting workpapers to test whether material values in the RBC report were properly classified, valued and included (e.g., catastrophe risk exposure data, C-3 Phase II, Modco reinsurance adjustments, separate account assets)</p>

Identified Risk	Branded Risk	Exam Asrt.	Critical Risk	Possible Controls	Possible Test of Controls	Possible Detail Tests
				<p>The company reconciles data filed in support of the RBC calculation <u>(including any manual adjustments)</u> back to system data and/or source documentation.</p> <p>The company utilizes the same modeling approach, assumptions and data to determine significant components of its RBC charge (e.g., catastrophe risk exposure, C-3 Phase II) as it uses for its own internal risk management and regulatory accounting/reserving purposes.</p>	<p>completeness and accuracy of the insurer's RBC report. Contact the NAIC quality assurance department if such correspondence is unavailable.</p> <p>Test the insurer's reconciliation of supporting data back to the system and/or source documentation.</p> <p>Test the operating effectiveness of company controls to verify that modeling approaches, assumptions and data used to determine significant components of RBC charges are reconciled/agreed to those used in internal risk management and accounting/reserving processes.</p>	<p><u>in accordance with SSAP guidance and RBC instructions. Compare the data provided in the RBC filing against other filings and information available to the department for consistency.</u> (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.)</p> <p>Determine the impact of examination changes on the RBC calculation.</p> <p>Compare the modeling approaches, assumptions and data filed in support of RBC calculations with those used by the company for internal risk management and regulatory accounting/reserving purposes <u>(including interrogatories, actuarial filings, AS exhibits, etc.)</u>. Investigate any significant variances <u>or inconsistencies</u> for appropriateness.</p>