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

The Liquidity Risk Assessment is focused primarily on overall liquidity, liquidity of investments, receivables, and cash flow from operations. In analyzing liquidity risk, analysts may analyze specific types of investments and receivables held by insurers. An analyst’s risk-focused assessment of liquidity risk should take into consideration the following areas (but not be limited to):

* Liquidity ratios/metrics
* Liquidity of certain investments, including private placement bonds and common stock, highly structured investments, investments on Schedule BA, and affiliated investments
* Liquidity of certain receivables, including health care receivables and special deposits
* Cash flow from operations
* Stockholder dividends
* Surrender and withdrawal activity for life insurers

Refer to IV.A. Supplemental Analysis Guidance – Financial Analysis and Reporting Considerations for general information and a primer on derivatives.

# General Guidance

To assess liquidity risk, consider the procedures, including specific data elements, metrics and benchmarks in this chapter. Analysts are not expected to document every procedure, data, or benchmark results. Rather analysts and supervisors should use their expertise, knowledge of the insurer and professional judgement to tailor the analysis to address the specific risks of the insurer and document of the applicable details within the analysis. Results of liquidity risk analysis should be documented in Section III: Risk Assessment of the insurer. Documentation of the risk assessment analysis should be sufficiently robust to explain the risks and reflect the strengths and weaknesses of the insurer.

Analysts should complete their liquidity risk assessment in conjunction with the Supervisory Plan and Insurer Profile Summary and the prior period analysis. Communication and/or coordination with other internal departments are a critical step in the overall risk assessment process and are a crucial consideration in the review of certain procedures.

Analysts should also consider the insurer’s corporate governance which includes the assessment of the risk environment facing the insurer in order to identify current or prospective solvency risks, oversight provided by the board of directors and the effectiveness of management, including the code of conduct established by the board.

# Annual Liquidity Risk Assessment

**Insufficient Overall Liquidity (or Illiquid Assets are Significant)**



Evaluate the insurer’s liquidity position, and examine its ability to meet financial obligations as they come due, including claim payments, operational expenses, and other financial commitments. Less liquid assets may be unavailable to pay policyholder claims as they are not as easily or quickly marketable. The assessment of liquidity involves a detailed analysis of changes in the insurer’s liquid assets, asset-to-liability ratios, and liquidity trends. Comparison with industry averages and peer companies offers valuable insights into the insurer’s liquidity standing within its market segment.

Procedures / Data

* Analyze the insurer’s liquidity position by reviewing the following metrics and data elements:
  + Change in liquid assets
    - an insurer’s it
  + Ratio of restricted assets to total cash and invested assets
    - Assessment of materiality of restricted assets is intended to determine if any liquidity concerns exist regarding the level of assets not under the insurer’s exclusive control. Analysts should review General Interrogatories and Notes to the Financial Statement #5 to determine the reason the assets are not under the insurer’s exclusive control (e.g., loaned to others, subject to repurchase or reverse repurchase agreements, pledged as collateral, placed under option agreements) and who holds the assets in order to evaluate whether there are liquidity concerns. Analysts should also consider the potential for pledging additional assets, as in variation margin requirements for derivatives transactions.
  + Ratio of adjusted liabilities to liquid assets (P/C)
    - The P/C liquidity ratio calculation compares the insurer’s adjusted liabilities with its liquid assets (IRIS ratio #9) available to fund future liabilities. Affiliated holdings are excluded from liquid assets because they are considered less liquid and may not be readily converted to cash. In addition to assessing the insurer’s current liquidity ratio, analysts should review the five-year trend within the Financial Profile Report. Significant fluctuation should be noted and the underlying causes analyzed.
  + Ratio of capital and surplus and AVR to total assets less separate accounts (Life/A&H)
    - For life insurers, analysts should be aware that stress liquidity inquiries and templates are included in the NAIC *Financial Condition Examiners Handbook*. Information captured in these templates is considered confidential; therefore, it is not captured within the annual financial statements. In order to obtain this information, regulators must request that reporting entities complete the forms. As noted in the *Examiners Handbook*, requests for reporting entities to complete these templates may occur at any time and are not limited to instances of comprehensive statutory examinations. Analysts should communicate with the examiner to determine if the insurer has recently submitted responses to the stress liquidity inquiries and templates or if a request should be made to the insurer for the information.
  + Ratio of total liabilities to liquid assets (Health)
  + The primary method in evaluating a health entity’s liquidity is accomplished comparing its liabilities with its liquid assets available to fund such liabilities in the future. However, as previously mentioned, various other comparisons can be used to help assess liquidity or potential liquidity concerns. Liquid assets in this calculation include all bonds but exclude affiliated investments. A significant increase in the liabilities to liquid assets ratio could indicate the health entity’s growing inability to satisfy its financial obligations without having to sell long-term investments. Liquid assets in this calculation include all bonds but exclude affiliated investments.
  + Ratio of liquid assets and receivables to current liabilities (Health)
    - This ratiomeasures the health entity’s ability to pay current obligations with current assets including marketable securities. Results of less than 200 percent may not pose a serious threat to the health entity if it has access to other assets that can be liquidated. This ratio excludes non-investment grade bonds and affiliated investments but includes certain receivables not included in the two procedures above.
  + Ratio of aggregate write-ins for other than invested assets to capital and surplus (Health)

Additional Review Considerations

* Review the trends over years in the liquidity ratios noted above and not any unusual fluctuations or negative trends between years.
* Compare the results of liquidity ratios noted above with industry or peer group averages to identify any significant deviations.
* Review the Annual Supplemental Investment Risks Interrogatories. Note any unusual items or areas that would indicate inadequate liquidity.
* Request and review the insurer’s most recent investment plan. Determine if the investment plan is adequate to meet the liquidity needs of the insurer’s liability structure.
* If there are concerns regarding liquidity or cash flows:
  + For a P/C insurer, consider having a cash flow analysis performed by an actuary.
  + For a Life/A&H or Health insurer, review the Statement of Actuarial Opinion for comments regarding cash flow testing performed and the results obtained.
* If an examination is in progress or recently completed, communicate with the examiner to determine if the insurer has recently provided responses to the stress liquidity inquiries and templates included in the NAIC *Financial Condition Examiners Handbook*. If such has occurred, review this information to ascertain whether the analyst’s liquidity concerns have been alleviated. If not, request the insurer to submit responses to these inquiries.
* If restricted assets are material, gain an understanding and assess the types of investments and products that may require collateral to be posted (e.g., derivatives, guaranteed investment contracts (GICs), Federal Home Loan Bank, etc.).
* If concerns are identified regarding overall liquidity of the asset portfolio, identify and assess other sources of liquidity available to the insurer. Request information from the insurer if necessary.
* Assess the impact of market conditions through consideration of industry and economic events (i.e., news, industry analytics). Is the analyst aware of any market conditions that may threaten the liquidity of insurers’ investment portfolios (e.g., market dislocation or other events that could affect liquidity of assets classes such as structured securities, structured notes, Schedule BA assets, non-investment grade bonds)?

# Risk of Insufficient Liquidity for Health Entities

There are a number of situations that can elevate the risk of a negative impact on a health entity’s cash flow and liquidity including the credit risk of receivables, the level of borrowed money and other liabilities, and dividends to shareholders. For example, if a health entity relies heavily on risk transfer arrangements with provider groups and the parties involved in the arrangements are unable to meet their obligations, the collectability of those obligations could negatively impact the liquidity of the health entity. Credit risk is a concern for other receivables as well, including amounts due from affiliates and reinsurance receivables. An analyst should be aware of the domiciliary state’s requirements for downstream risks such as provider groups and reinsurance. Other situations involve significant increases in liabilities such as unpaid claim reserves or borrowed money, which can increase the health entity’s short-term cash requirements. Additional cash would also be needed in order for the health entity to pay dividends to a parent company or other shareholder.

Health entities have a shorter benefit payout period than other insurers, and consequently understanding the need for liquidity is an important issue for management. Because a health entity writes short-tail business, it will generally have a shorter average maturity on its bonds and hold more cash and short-term investments than other insurers. The key liquidity risks to a health entity include substantial declines in enrollment, underpricing, and spikes in claims. If this were to occur, the entity’s cash outflows for claims payments would exceed its inflows from newly received premiums. However, a health entity with a relatively stable enrollment and claims experience within expectations may feel it can safely accept some durational mismatch between its assets and liabilities and may invest in more long-term invested assets in order to increase its investment yield. Therefore, the analyst should consider reviewing the Pricing/Underwriting Risk Assessment in conjunction with Liquidity. Those health entities writing long-tailed business may also own long-term invested assets to support those lines’ liabilities.

Z-Score Analysis (Health Only)

The Z-Score analysis included in the Annual Financial Profile. The Z-Score is a way to measure and monitor financial performance by analyzing specific ratios over a period of time. If a result of less than 2.6 occurs, analysts should consider reviewing the individual ratios within the Z-Score. An unstable trend of the Z-Score or a low Z-Score may indicate increased risk to the solvency of the health entity and analysts should take a closer look at each of the ratio results in the Financial Profile. There are four ratios in the Z-Score; however, the Z-Score places the most emphasis on working capital and earnings. The following briefly explains each ratio within the Z-Score, although more detail is available in the link to the *Z-Score Document* on iSite+.

* *Working Capital to Total Assets* measures the ability of a health entity to manage working capital, which is fundamental for all business. While a health entity may have sufficient surplus, they may have insufficient working capital to pay claims due to related party transactions and other non-liquid long-term investments. Analysts should also consider that while working capital may be above the threshold, it may still not provide a sufficient cushion for significant unexpected losses. Refer to the discussion of procedure #1c above.
* *Retained Equity to Total Assets* reflects the age of the business and the philosophy of management. This assumes that a more mature business would normally have more capital and surplus. Companies that have been in business fewer years and have insufficient management experience tend to have higher failure rates.
* *Earnings Before Interest & Taxes (EBIT) to Total Assets* measures a health entity’s earnings performance. This ratio is weighted the highest for several reasons including the following: 1) significant shifts in earnings may indicate a highly risky industry with unstable cash flows; 2) health entities must balance consumer demands with cost management; and 3) Medicare and Medicaid programs and other outside factors can have a significant impact on the health entity’s financial condition.
* *Capital and Surplus to Total Liabilities* is the leverage measure within the Z-Score and is the inverse of the traditional debt to equity ratio.

Procedures / Data

* Total Z-Score.
* Decrease in Z-Score from the prior year where the total Z-Score is 6.0 or less in the current year.
* Decrease in the Z-Score over the past three years if the Z-Score is 6.0 or less in the current year.
* Ratio of working capital to total assets.
* Review the working capital to total assets ratio for the past years and assess any unusual fluctuations or negative trend.

**Impact of Volatility in the Value of Bond Portfolio on Liquidity**

**Impact of Maturity of Bond Portfolio on Liquidity**

Bond holdings are a substantial component of most insurers' investment portfolios. Their value and maturity can significantly affect an insurer's liquidity. Bond prices fluctuate due to factors like interest rate changes, issuer creditworthiness, and economic conditions. A decline in bond values can reduce an insurer's overall assets and potentially impact its liquidity. The maturity of an insurer's bond portfolio is also crucial. Short-term bonds offer more predictable cash flows as they approach redemption, benefiting insurers needing to meet regular claims payments or other liquidity demands. Longer-term bonds are more sensitive to interest rate changes. Bond prices and interest rates have an inverse relationship. Rising interest rates can decrease the value of existing bonds, potentially affecting an insurer's liquidity.

Procedures

* Review the Annual Financial Statement, Schedule D – Part 1A – Section 2 and identify any material fluctuations/trends.
* Determine if the the maturity of the insurer’s bond portfolio aligns with its most recent investment plan and adequately matches future liabilities.
* Review the Annual Financial Statement, Schedule D – Part 1 and determine the extent to which the fair value of bonds varies from the statement value. Assess the impact of such variance on the insurer’s overall liquidity.
* Review the Annual Financial Statement, including Notes to Financial Statements – Note #5 to assess if there are liquidity concerns due to a material exposure to highly structured bonds, including RMBS, loan-backed and structured securities and structured notes.

**Exposure to**

Procedures / Data

* Ratio of private-placement bonds owned to policyholder surplus (P/C), to capital and surplus plus AVR (Life/A&H) and to capital and surplus (Health)
* Increase in private placement bonds from the prior year

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* For significant privately-placed bonds rated by a chief revenue officer, review the issuer’s rating or request the Securities Valuation Office’s assessment of the designation to evaluate the issuer’s financial position and ability to repay its debt.

**Exposure to Other Invested Assets (Schedule BA)**

Other Invested Assets (or Schedule BA Assets) are long-term investments not clearly or normally categorized within other asset schedules. These investments often involve a higher degree of complexity or illiquidity. Examples include joint ventures and partnerships, structured securities, oil and gas production, mineral rights, surplus debentures, collateralized and non-collateralized loans, and other specialized investments. While generally considered less liquid, the liquidity of Schedule BA Assets can vary significantly based on market conditions and the specific nature of each asset.

Specific liquidity risks related to BA Assets may include:

* Significant amount of Schedule BA assets held with commitments/ collateral requirements—Schedule BA assets may include commitments for additional funding, which is common in private equity funds. Schedule BA assets may have the potential to be required to post additional collateral, similar to variation margin for derivatives.
* Expected cash flows from Schedule BA assets and types of other structured bonds—Certain Schedule BA assets and highly structured bonds, including RMBS, LBaSS, and structured notes, may include liquidity risks where expected cash flows do not match the actual cash flows.
* Significant amount of BA Assets held with resale restrictions—Illiquidity of certain assets may be due to provisions of the asset, such as restrictions on resale. (E.g., certain BA assets, such as investment hedge funds, may have time restrictions on when investment can be sold/liquidated.)

Procedures / Data

* Ratio of Schedule BA Assets to policyholder surplus (P/C), to capital and surplus plus AVR (Life/A&H) and to capital and surplus (Health)
* Increase in Schedule BA Assets from the prior year

Additional Review Considerations

* Review Annual Financial Statement – Schedule BA to detrmine whether the insurer invested in any assets, such as hedge funds or private equity funds, that may include restrictions on an investor’s ability to liquidate the assets, commitments for additional funding (common in private equity funds), or have the potential to be required to post additional collateral.

**Exposure to Illiquidity of Collateral Loans (Life/A&H)**

Determine whether there are concerns due to the level of investment in collateral loans.

Procedures / Data

* Ratio of collateral loans to capital and surplus plus AVR
* Increase in the ratio of collateral loans to cash and invested assets from the prior year

Additional Review Considerations

* Review Annual Financial Statement, Schedule BA – Part 1 and Schedule DA – Part 1 and perform the following for each collateral loan:
  + Determine whether the collateral for the loan is an acceptable asset
  + Determine whether the collateral loan is to an officer, parent, subsidiary, or affiliate

**Exposure to Restricted Assets within the Securities Lending Program, or**

**Liquidity of Reinvested Collateral within the Securities Lending Program-(P/C and Life/A&H)**



Determine if concerns exist regarding the materiality of securities lending activity and the nature of the reinvested collateral.

Procedures / Data

* Does the reporting entity engage in securities lending transactions?
  + Ratio of securities lending collateral reinvested to total assets
  + Aggregate total collateral received

Additional Review Considerations

* Review Annual Financial Statement investment schedules, General Interrogatories, and Notes to Financial Statements to gain an understanding of the scope of the securities lending program and restricted assets, and to understand how the cash collateral is reinvested (Schedule DL).

**Illiquidity of Separate Account Assets, or**

**Negative Economic Impacts on Liquidity of Separate Accounts (Life/A&H)**



Determine the materiality of separate account assets and the potential impact on the liquidity of the insurer in the event of large withdrawals from separate accounts. Liquidity risks related to separate accounts can include:

* Illiquidity of separate account assets—Risk that liquid assets are insufficient to meet surrender benefits, resulting in insufficient cash flows.
* Negative economic impact on separate account liquidity—Risk that market decline results in the need for policyholder cash, resulting in the potential negative impact or a “run on the bank” scenario.

Procedures / Data

* Does the reporting entity engage in securities lending transactions with separate account transactions?
  + Ratio of total separate account assets to total assets
  + Aggregate total collateral received

Additional Review Considerations

* Review the investment schedules, General Interrogatories and Notes to the Financial Statements to gain an understanding of the scope of the securities lending program and restricted assets, and to understand how the cash collateral is reinvested (Schedule DL).
* Does the reporting entity report Federal Home Loan Bank (FHLB) funding agreements within the separate account(s)? If so, assess the materiality of the FHLB agreements.

**Exposure to Affiliated Investments**



### This procedure involves assessing the significance of investments in affiliated companies. Affiliated investments are often illiquid, which can negatively affect the insurer’s overall liquidity, especially when they constitute a significant portion of its portfolio. Investments in parent, subsidiaries, or affiliates (PSA) may not be marketable and unavailable to pay policyholder claims. Excessive affiliated investments may also divert capital from other opportunities with potentially higher returns. Therefore, a thorough analysis of the business purpose and benefits of such investments is essential. When affiliated investments are substantial, analysts should carefully review the financial statements of the affiliate to gain a comprehensive understanding of its financial health and potential risks.

Procedures / Data

* Ratio of affiliated investments to policyholder surplus (P/C), to capital and surplus plus AVR (Life/A&H) and to capital and surplus (Health)
* Change in total affiliated investments from the prior year
* Change in any category of affiliated investments from the prior year

Additional Review Considerations

* If the Company owns interest in the capital stock of another insurance company, review Schedule Y to determine if the investment was properly disclosed.
* Review the results of the Holding Company Analysis completed by the lead state to determine if any concerns exist regarding affiliated entities.
* Review Annual Financial Statement, Notes to Financial Statements, Note #10 and Note #14 to identify if the insurer is subject to any guarantees or other commitments to (PSA). If the guarantee or commitment is material to the insurer, assess the nature of the agreement and the financial strength of the PSA.

**Exposure to Other Less Liquid Receivables (Health)**



### Review the assets of a health entity that may have limited marketability, such as furniture, equipment, and software.

Furniture and equipment includes not only administrative furniture and equipment but also health care delivery assets such as furniture, medical equipment and fixtures, pharmaceuticals and surgical supplies, and durable medical equipment.

*Statement of Statutory Accounting Principles* (SSAP) *No. 73*—*Health Care Delivery Assets and Leasehold Improvements in Health Care Facilities* describes health care delivery assets as those assets that are used in connection with the direct delivery of health care services in facilities owned or operated by the health entity. SSAP No. 73 further provides that these types of assets shall be admitted provided they meet the definitions of health care delivery assets as set forth in the SSAP. As a result of this accounting guidance, it is possible that a health entity with these types of assets will have a much different mix of assets than other health entities that do not use these types of assets in its operations. It should be noted that the depreciation period for health care delivery assets is limited to three years, which varies from the depreciation period for similar assets that are non-admitted.

Analysis of these assets should consist primarily of ongoing monitoring of the balances, the relative change, and the relationship of that change with what is expected based upon other trends/activity within the health entity.

As discussed in SSAP *No. 16R*—*Electronic Data Processing Equipment and Software,* electronic data processing (EDP) equipment and operating system software are admitted assets to the extent they conform to the requirements of *SSAP No. 4—Assets and Nonadmitted Assets*. The admitted asset is limited to three percent of capital and surplus; adjusted to exclude any EDP equipment and software, net deferred tax assets and net positive goodwill. However, SSAP No. 16R provides that non-operating system software is a non-admitted asset. EDP equipment and software depreciated for a period not to exceed three years using methods detailed in *SSAP No. 19—Furniture, Fixtures, Equipment and Leasehold Improvements*.

EDP assets generally are subject to various state specific limitations, such as a minimum amount that can be capitalized as an asset, a maximum depreciable life, and/or limits that may be admitted as a percentage of total admitted assets or capital and surplus. These limitations are put in place to avoid undue concentrations of assets that have less marketability than other admitted assets and rapid technological obsolescence. Because of this, the amount reported by a health entity is generally limited to an amount that is not significantly material to the health entity’s financial position. It is also common to find that the health entity reports no EDP assets. In these cases, the health entity often relies upon a parent or an affiliated company to provide EDP services with a resultant charge back through a management or service agreement.

Analysis of EDP assets should consist primarily of ongoing monitoring of the balances, the relative change, and the relationship of that change with what is expected based upon other trends/activity within the health entity.

Procedures / Data

* Ratio of admitted furniture, equipment and supplies to capital and surplus
* Change in the admitted balance of furniture, equipment and supplies from the prior year
* Ratio of admitted EDP equipment and software to capital and surplus
* Change in admitted EDP equipment and software from the prior year

Additional Review Considerations

* Review Annual Financial Statement – Exhibit 8 for the reporting distribution of furniture, equipment and supplies.
* If there are concerns regarding furniture, equipment and supplies, request and review:
  + Clarification of any unusual responses from its independent auditor.
  + Information regarding depreciation and review for reasonableness. Determine if the depreciation period exceeds three years.
* Regarding EDP equipment:
  + Review disclosures in the Notes to the Audited Financial Report for reasonableness.
  + Perform a review to determine whether the minimum capitalization amount, depreciable life and admissibility are in compliance with statutory limitations.
  + Request a description of the methodology used to compute depreciation.
    - Determine if the period of depreciation exceeds three years.
    - Determine if the insurer non-admitted non-operating software.
* Review the management or service agreements, if any, which provide for EDP services and evaluate whether the charges appear reasonable for the services provided.
* If the insurer did not report an asset for EDP equipment and operating system software, does a management or service agreement exist that provides for electronic data processing services?

**Significant Amount of Special Deposits**



Determine if the insurer is exposed to greater-than-normal liquidity risk with respect to special deposits.

Special deposits are segregated into two sections: 1) for the benefit of all policyholders; and 2) all other special deposits. Both categories reflect amounts aggregated by state. Deposits for the benefit of all policyholders are held by individual states. The assets composing these deposits are held on the various investment schedules in the financial statement. However, the assets are not held in custody of the insurer, and restrictions are placed on the assets disposal. Special deposit assets may be unavailable to pay policyholder claims. In a situation of a rehabilitation of an insurer or a troubled insurer, these restrictions on assets may cause concerns, particularly those not held for the benefit of all policyholders.

This procedure also assists analyst in determining if the domiciliary state may be having difficulty in calling deposits that are deemed “all other special deposits,” specifically when the level of deposits that are not for the benefit of all policyholders as a percentage of total assets is high, or in cases when the insurer has been determined to be troubled. Analysts may consider this assessment necessary in either of those cases because, once the insurer has moved into rehabilitation, the cash flow position of the insurer may deteriorate rapidly.

Procedures / Data

* Review Annual Financial Statement – Schedule 3 Part 3 to determine if any concerns exist regarding special deposits.
  + Ratio of book adjusted carrying value of total special deposits to total net admitted assets.
  + Ratio of book adjusted carrying value of all other special deposits (not for the benefit of all policyholders) to total special deposits.
  + Difference between the book adjusted carrying value and fair value of total special deposits.

Additional Review Considerations

* Review the listing of special deposits held by the insurer not for the benefit of all policyholders and there is overall liquidity risk regarding the insurer, consider:
  + The number of states in which the insurer has these types of deposits. The greater the number, the more difficult it could be for the domiciliary state to call on these deposits in a rehabilitation.
  + The amount of concentration in any one particular state.
* Contact the domiciliary state or perform research to determine if any of the states have restrictions on the ability of those deposits to be called by the domiciliary state during a rehabilitation.

**Liquidity Strain of Surrender and Withdrawal Activity (Life/A&H)**



Determine whether surrenders and withdrawals on life and annuity products are significantly affecting the insurer’s liquidity position and are trending negatively. In addition, significant levels of guaranteed interest contracts or amounts subject to minimal or no surrender charges can be identified as well.

Liquidity strain of surrenders and withdrawals may be the result of:

* Market decline that results in the need for policyholder cash, resulting in the potential negative impact on availability of liquid assets or a “run on the bank” scenario.
* That liquid assets are insufficient to meet surrender benefits, resulting in insufficient cash from operations.
* Poor asset-liability matching and the potential negative impact

Procedures / Data

* Ratio of surrender benefits and withdrawals on deposit-type contracts to net premiums and deposits on deposit-type contracts
* Ratio of group surrenders to net group premiums in group annuities where group annuity surrenders exceed 20% of total surrenders
* Ratio of surrender benefits and withdrawals on deposit-type contracts to capital and surplus

Additional Review Considerations

* Review Annual Financial Statement, Notes to Financial Statements, Note #32. Determine if the insurer has a material amount of annuity reserves that can be withdrawn with minimal or no charge. (See the Financial Profile Report.)
* Determine which lines of business had significant surrender activity during the year or if there appears to be a negative trend in surrender activity over the past five years.
* Review the insurer’s plan descriptions and/or policy forms to better understand the types of plans offered and the specific policy withdrawal features and surrender charges.

**Negative (or Negative Trend in) Cash Flow from Operations**



The Statementa comprehensive overview of an insurer’s cash ssItinto three primary areas:,ing, and financingBy examining these components, analysts can gain valuable insights into the insurer’s liquidity and overall financial health.

Identify situations where the insurer’s operations are generating negative cash flow. Negative cash flow in this area can signal underlying financial weaknesses, such as increased claims activity, inefficient expense management, changes in premiums collected due to revised business strategy or reinsurance agreements, among other factors that can drive negative cash flow from operations. Negative trends in cash flow from operations may create liquidity needs that may result in the sale of investments at a loss. Negative cash flow from operations should be evaluated closely for persistent negative trends. Additionally, analysts may scrutinize the insurer’s reliance on investment income to offset negative cash from operations. While this practice is not inherently problematic, excessive reliance can indicate potential vulnerabilities to market fluctuations. For life insurers, analysts should also closely evaluate significant net transfers to or from separate accounts, as this could provide insights regarding potential financial problems.

The Cash Flow Statement also provides valuable information about how the insurer finances negative cash from operations. This can involve borrowing funds, issuing surplus notes, or receiving capital support from the parent company. Conversely, positive cash flow from operations is a positive indicator, suggesting the insurer’s ability to generate sufficient revenue and manage claims and expenses effectively. Analysts may explore how this positive cash flow is allocated, whether it is reinvested in the business or returned to stockholders through dividends. A high reliance by affiliated companies on dividends paid by the insurer may represent an ongoing liquidity need.

Procedures / Data

* For Property/Casualty:
  + Ratio of net cash from operations to policyholders surplus
* For Life/A&H:
  + Ratio of net cash from operations to to capital and surplus
  + Ratio of prior year net cash from operations to capital and surplus
  + Ratio of net cash from operations to premium income
  + Ratio of other cash provided (applied) to capital and surplus
  + Ratio of other cash provided (applied) to net cash from operations
  + Change in other cash provided (applied) from the prior year
  + Ratio of net transfers to or from separate accounts to capital and surplus
* For Health:
  + Ratio of net cash from operations to capital and surplus
  + Ratio of prior year net cash from operations to capital and surplus
  + Ratio of net cash from operations to premium income
  + Ratio of other cash provided (applied) to capital and surplus
  + Ratio of other cash provided (applied) to net cash from operations
  + Change in other cash provided (applied) from the prior year
  + Ratio of benefits and loss related payments to premiums collected net of reinsurance
    - When the time it takes to pay claims lengthens, the liability for unpaid claims generally increases. An analyst should consider also reviewing the health entity’s liability for unpaid claims balances, since an understatement of these liabilities could overstate the results of other cash flow metrics, such as net cash from operations to capital and surplus, net cash from operations to net premium income, and change in other cash provided (applied) from the prior year. An increase in current liabilities increases the health entity’s current cash requirements. A longer claims payment period could indicate the health entity is holding cash for other purposes.
  + Average number of days of unpaid claims

Additional Review Considerations

* Review the cash flow from operations to determine the underlying cause of the negative cash flow.
* Review the trend in net cash from operations for the past five years and note any unusual fluctuations or negative trends between years.
* Describe any material commitments for capital expenditures as of the end of the reporting period indicating the purpose, anticipated source of funds, changes between equity and debt, and any off-balance sheet financing agreements.
* Compare cash flow from operations with the industry and peer group (Peer Financial Report) in order to identify significant deviations.
* Life/A&H: Review the trend in transfer to/from separate accounts for unusual fluctation, such as significant reliance on cash provided from separate accounts and significant trends in providing cash to separate accounts.
* Health: Review the sources, including the Management’s Discussion and Analysis and the Asset Adequacy Analysis from the Statement of Actuarial Opinion (if required) to determine if concerns exist relating to cash flow and liquidity or asset adequacy.
  + An asset adequacy analysis is generally not required for a health entity; however, for companies filing the health blank that also write life business, this may be required.
* Health: Review changes in the average number of days of unpaid claims in past years for unusual fluctuations or negative trends between years.

**Related Party Exposure in the Investment Portfolio**



Determine related party exposure in the investment portfolio and assess any related liquidity risk.

Related parties are entities that have common interests as a result of ownership, control, affiliation or by contract as definited in *SSAP No. 25—Affiliates and Other Related Parties* (SSAP No. 25). Refer to the *Insurance Holding Company System Model Act* (Model #440) and SSAP No. 25 for a broader definition of "affiliate,” “related party” and “control”.

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. As such, related party transactions require specialized accounting rules and increased regulatory scrutiny.

The anlayst should utilize the tools available in iSite+ to identify if the insurer has a material exposure to investments involving related parties, either on an asset category basis or in aggregate, and by the related party designation noted below. If a material exposure exists, further assessment of the [credit, market, liquidity] risk may be warranted. For example, what is the NAIC designation of investments involving related parties? Analysts may also consider the extent to which related parties are involved in securitizing or originating business for the insurer, and what differences may exist in how investments involving related parties are valued. If the role of the related party is that of a third-party advisor, factors to consider may include for example, the expertise of the related party advisor, any potential conflicts of interest, and if related parties are originating investments only for the insurer or also to the public, the latter being subject to SEC requirements. The analyst may consider utilizing suggested procedures in the “Additional Procedures” section on third-party advisors, if applicable.

Within the Annual Financial Statement investment Schedules B, BA, D, DA, DB, DL, and E (Part 2), all investments involving related parties must incude disclosure to ensure full transparency. This disclosure is in the column “Investments Involving Related Parites”. It designates investments by the following roles:

1. Direct loan or direct investment (excluding securitizations) in a related party, for which the related party represents a direct credit exposure.

2. Securitization or similar investment vehicles such as mutual funds, limited partnerships and limited liability companies involving a relationship with a related party as sponsor, originator, manager, servicer, or other similar influential role and for which 50% or more of the underlying collateral represents investments in or direct credit exposure to related parties.

3. Securitization or similar investment vehicles such as mutual funds, limited partnerships and limited liability companies involving a relationship with a related party as sponsor, originator, manager, servicer or other similar influential role and for which less than 50% (including 0%) of the underlying collateral represents investments in or direct credit exposure to related parties.

4. Securitization or similar investment vehicles such as mutual funds, limited partnerships and limited liability companies in which the structure reflects an in-substance related party transaction but does not involve a relationship with a related party as sponsor, originator, manager, servicer or other similar influential role.

5. The investment is identified as related party, but the role of the related party represents a different arrangement than the options provided in choices 1-4.

6. The investment does not involve a related party.

Procedures

* Review the Annual Financial Statement investment schedules, as disclosed in the column “Investments Involving Related Parties” and utilizing iSite+ tools, determine if the insurer has material related party exposures in its investment portfolio. This disclosure is included in Schedule B, Schedule BA, Schedule D, Schedule DA, Schedule DB, Schedule DL, and Schedule E, Part 2.
  + Consider exposure by asset class and in aggregate, and by the role of the related party in the investment as designed by the “Investments Involving Related Parties” disclosure.
* If concerns exist regarding a material related party exposure in the investment portfolio, assess the credit quality of those investments involving related parties by reviewing designations, assessing historical default experience, etc.
* If concerns exist regarding a material related party exposure in investment management or advisory services, consider the following:
  + Review the procedures in the “Additional Procedures” section below regarding Third Party Investment Advisors and consider their application to related party advisors in that role.
  + In addition to the additional analysis procedures regarding third party investment advisors, consider the following:
    - Review the insurer’s investment policy guidelines and determine whether the related party investments follow the guidelines and are in compliance with regulatory requirements.
    - Review whether the fee structure for asset management is fair, reasonable, and appropriately recognized as investment expenses.
    - If the related party asset manager also originates/securitizes investments held by the insurer, consider requesting additional information from the insurer to determine the following:
      * Whether the asset manager has adequate experience and knowledge in originating and managing the types of investments;
      * Whether the asset manager follows appropriate underwriting practices and applicable regulatory requirements in originating investments; and
      * Whether the fee structures embedded in securities (if applicable) are fair, reasonable, and appropriately account for potential duplication of fees or conflicts of interest.

**Invested Asset Exposure to Climate Change, Transition and Asset Devaluation Risk**



Identify and assess the potential exposure of the insurer’s investment portfolio to the impact of material climate change and/or energy transition risks and asset devaluation risk. The insurer’s investment portfolio is subject to prospective devaluation of the assets/changes in the asset return associated with its holdings of climate-affected assets. Transition risks refer to stresses on certain investment holdings arising from the shifts in policy, consumer and business sentiment, or technologies associated with the changes necessary to limit climate change. A few examples of investment holdings and sectors generally subject to greater levels of transition risk include, oil/gas, transportation, heavy manufacturing, and agriculture. In assessing an insurer’s exposure to these risks, the analyst is encouraged to review information disclosed by the insurer in its responses to the NAIC’s Climate Risk Disclosure Survey, U.S. Securities and Exchange Commission (SEC) filings, and/or the Own Risk and Solvency Assessment (ORSA) Summary Report filings. In addition, the analyst is encouraged to review the results of basic scenario analysis conducted by the NAIC using insurers’ Annual Statement filings (U.S. Insurance Industry Climate Affected Investment Analysis) to identify potential concentrations in exposure.

Procedures

* Review information provided in the insurer’s response to the NAIC’s Climate Risk and Disclosure Survey (if available) on its exposure to material climate change/energy transition risk and related mitigation activity in this area.
* Review relevant information provided in the Own Risk and Solvency Assessment (ORSA) Summary Report, and/or U.S. Securities and Exchange Commission (SEC) 10-K or 10-Q filings (if available) that discusses the insurer’s exposure to material climate change/energy transition risk and related mitigation activity in this area.
* Review information provided in the NAIC’s U.S. Insurance Industry Climate Affected Investment Analysis to identify potential concentrations in insurer exposure.

Additional Review Considerations

* Review the insurer’s investment policies and strategies to assess whether material climate change, transition and asset devaluation risk considerations have been appropriately implemented into the company’s investment processes.
* Review the most recent examination report and summary review memorandum (SRM) for any findings regarding climate change/energy transition risks.
* If concerns exist, consider requesting information from the insurer regarding how the insurer manages its exposure to material climate change/energy transition risk, including how it identifies and estimates current and prospective exposures and the limits (if any) in place to avoid concentrations.

**Significant Assessments Against Policy Benefits (Fraternal Only)**

Determine if the fraternal society has implemented assessments (i.e., liens) against policyholder benefits, which are generally used to increase surplus. If concerns exist, information should be gathered and assessed as to the nature and duration of the liens, and the use of the funds derived from the liens.

# Procedures / Data:

# For fraternal societies, did the society report outstanding assessments in the form of liens against policy benefits that have increased surplus?

# Assess the materiality of outstanding assessments. Review the ratio of total liens as a percentage of total current year surplus

# Were new assessments imposed in the current year? Review any information the department has on the nature and duration of the liens. [Annual Financial Statement, General Interrogatories – Part 2 – #35.2]

# Additional Procedures Applicable to Liquidity Risk

**Investment Policies and Strategy**

To assess the insurer’s investment strategy, considerrequesting and reviewing a copy of their formal adopted investment plan. Evaluate the plan to determine if it aligns with the insurer’s business, liquidity, and cash flow needs. Additionally, verify whether the insurer is adhering to the plan’s guidelines for the following:

* *Investment Qualitfy and Diversification:* Evaluate the quality of investments, diversification standards (issuer, industry, duration, liquidity, geographic location), and exposure to climate-related risks.
* *Performance:* Compare expected and actual investment returns.
* *Investment Growth:* Analyze planned increases in investment types, sectors, and markets.
* *Asset-Liability Analysis:* Assess whether the investment plan aligns with the insurer’s liability structure. This may involve reviewing asset adequacy analysis and discussing the insurer’s plans with management.

Upon review of the investment plan, compare the plan to actual results to help determine if the insurer and its investment manager(s) appear to be adhering to the investment policies and guidelines in the investment plan.

**Examination Findings**

Consider reviewing the recent examination report, Summary Review Memorandum (SRM) and communication with the examination staff to identify if any findings regarding liquidity risks associated with:

* Asset liability matching and cash flow stress testing
* Investment returns
* Climate change, transition, and asset devaluation
* Effective management of the insurer’s liquidity position
* Other-than-temporary impairment OTTI
* Investment valuation issues
* Adherence to investment policies and strategies
* Investment management, and use of and monitoring of external investment managers
* Determine if liquidity concerns identified during the last exam have been addressed.

If outstanding issues are identified, perform follow-up procedures as necessary to address concerns.

**NAIC Capital Markets Bureau Analytical Assistance**

Consider requesting the NAIC’s Capital Markets Bureau (CMB) to assist with investment portfolio or investment management agreement analysis. The CMB has different levels of analysis that can be arranged to assist the state.

**Third-Party Investment Advisors**

Determine whether concerns exist regarding the use of third-party investment advisers. As investments and investment strategies grow in complexity, insurers may consider the use of unaffiliated third-party 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 SEC and/or by the states in which they operate, generally based on the size of their business. In certain situations, insurers may use a broker-dealer for investment advice. 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–Uniform Application for Investment Adviser Registration and Report Form by Exempt Reporting Advisers, which provides extensive information about the nature of the organization’s operations. To locate these forms, analysts can go to [*www.adviserinfo.sec.gov*](http://www.advisorinfo.sec.gov) and perform a search based on the company name.

Key information provided on a Form ADV includes:

1. Regulatory agencies and states in which the adviser/broker is registered.
2. Information about the advisory business including size of operations and types of customers   
   (Item 5).
3. Information about whether the company provides custodial services (Item 9).
4. Information about disciplinary action and/or criminal records (Item 11).
5. A report of the independent public accountant verifying compliance if the investment advisor also acts as a custodian.

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 valuable to analysts in assessing the suitability and capability of investment advisers providing advisory services to insurers. In addition, although not expressly prohibited (as discussed at e. above), it is a best practice for the insurer to choose a national bank, state bank, trust company or broker/dealer which participates in a clearing corporation, other than its investment manager/advisor, to hold its assets in custody to promote segregation of duties. See additional guidance on custodial expectations in Section 1.F – Outsourcing of Critical Functions of the NAIC’s Financial Condition Examiners Handbook.

Analysts should consider any significant risks identified in the most recent risk-focused examination and whether any follow-up procedures were recommended by the examiner. The examiner may have performed steps to determine the following; whether the investment adviser is suitable for the role (including whether he/she is registered and in good standing with the SEC and/or state securities regulators); whether the investment advisory agreements contain appropriate provisions; whether the adviser is acting in accordance with the agreement; and whether management/board oversight of the investment adviser is sufficient for the relationships in place.

Analysts should determine if changes have occurred in the insurer’s use of investment advisers that may prospectively impact the insurer’s investment strategy and overall management of the investment portfolio. If changes have occurred, analysts may consider asking the insurer for an explanation for the change in investment advisers and obtain a copy of the new adviser agreement to gain an understanding of the provisions including the advisor’s authority, specific reference to compliance with the insurer’s investment strategy and/or policy statements, as well as state investment laws; conficts of interest; fiduciary responsibilities; fees; and the insurer’s review of the adviser’s performance. Refer to the Financial Condition Examiners Handbook for further guidance and see V. C. Domestic and/or Non-Lead State Analysis – Form D Procedures for additional guidance on reviewing affiliated investment management agreements.

Analysts can determine if the investment advisor is in good standing with the SEC. The SEC does not officially use the term “good standing”; however, for this analysis, the term is used to mean a firm that is registered as an investment adviser with the SEC and does not report disciplinary actions or criminal records in Item 11 of the Form ADV.

If the insurer uses an external asset manager and if investments on Schedule BA Assets are invested in funds that are affiliated with the asset manager or are managed by that asset manager, analysts should consider several possible issues that may result from this scenario. A possible concern may exist when the asset manager is also managing other funds in addition to managing assets for the insurer and then invests the insurer’s assets in those other funds that the asset manager manages. While those funds may be good investments, both in general and for the insurer, there are a few issues that may need to be considered. First, is the potential for a conflict of interest if the asset manager is using the insurer’s available funds to provide seed money or fund the manager’s other funds. Second, is if any concerns exist regarding the appropriateness of the fund for the insurer’s investment portfolio and if the transactions would be considered on an arm’s-length basis. Third, is the understanding that the insurer may be paying overlapping fees as the insurer would pay the asset manager a fee for the investment and then also pay a fee within the fund investment. There may be similar concerns with other complex investments such as structured securities that are originated by the asset manager or one of its affiliates/related parties. The fees associated with these investments could be considered arms-length and appropriate but would require further review and potentially additional support or documentation to make that determination.

* Assess and determine if any concerns exist regarding third party investment advisers and associated contractual arrangements.
  + Review Annual Financial Statement, General Interrogatories – Part 1 – #29.05. Does the insurer utilize third party investment advisors, broker/dealer or individuals acting on behalf of the insurer with access to their investment accounts?

If “yes”, consider the following procedures:

* + - Verify that all affiliated and unaffiliated investment advisors the analyst is aware of are disclosed in the interrogatory, whether primary or sub-advisors.
      * Verify that Investment Management Agreements required to be filed with the department have been filed and consider requesting copies of agreements that have not been filed with the department for review.
      * Gain an understanding of the types of investments that are being managed by each of the advisors/sub-advisors disclosed in the interrogatory.
    - Review the results of the most recent financial examination work papers, follow-up and prospective risk information and the summary review memorandum provided by the examiners. Did the examination identify any issues with regard to investment advisers and associated contractual arrangements that require follow-up analysis or communication with the insurer? If yes, document the follow-up work performed.
    - Compare Annual Financial Statement, General Interrogatories – Part 1 – #29.05 for the current year to the prior year to determine if there have been any changes in advisors.

If “yes”:

* + - * Consider obtaining an explanation for the change from the insurer.
      * Consider obtaining a copy of the new investment advisor agreement and review it for appropriate provisions.
* Using the information reported in Annual Financial Statement, General Interrogatories, Part 1 – #29.05, obtain and review SEC Form ADV (if available), to determine if the investment advisor is in good standing with the SEC. If not in good standing, contact the insurer to request an explanation.
* If agreements with third party investment advisers are affiliated, have the appropriate Form D – Prior Notice of Transactions been filed and approved by the department? Were any concerns noted or follow-up monitoring recommended?
  + See additional guidance in V. C. Domestic and/or Non-Lead State Analysis – Form D Procedures for reviewing affiliated investment manager agreements.
* Request information from the insurer regarding the background and expertise in any complex or non-traditional assets (such as structured securities, mortgage loans, investment funds) of its investment advisors (in-house and/or contractual) and its analytical system capabilities. Determine whether the advisors and systems are adequate to allow the insurer to continuously monitor its investments.
* If the insurer uses an external asset manager, consider if there are any investments that may represent a potential for conflict. Examples of this are (1) if there are Investments Report on Schedule BA that are funds that are affiliated/related with the asset manager or are managed by that asset manager, (2) Structured Securities in which the asset manager or an affiliate/related party had a role in originating, or (3) direct investments in the asset manager or any of its affiliates/related parties. If the external asset manager qualifies as a related party, utilize guidance provided in the “Related Party Exposure in the Investment Portfolio” section above to assist in this review. Consider the following issues:
  + - Have any potential conflicts of interest been reviewed and formally approved by the Board or Investment Committee.
    - If the investment is appropriate for the insurer’s portfolio and is arm’s-length.
    - If the insurer is paying overlapping fees.

**Inquire of the Insurer**

Consider requesting additional information from the insurer if liquidity risk concerns exist in a specific area. The list provided are examples of types of information or explanations to be obtained that may assist in the analysis of liquidity risk for specific topics where concerns have been identified.

* General Investment Inquiries
  + If management has adequately reviewed the investment portfolio and understand the yields, underlying collateral, cash flows and investment volatility.
  + Any additional concentration by collateral type.
  + Management’s process for valuing securities to assist the analyst in assessing if the securities are valued appropriately.
  + Management’s intended use of certain riskier investments and purpose within the insurer’s portfolio.
  + If management has an appropriate level of knowledge and expertise with the type of securities being purchased/held.
  + If the insurer has controls implemented to mitigate the risks associated with this investment type.
  + Sources of liquidity, such as letters of credit (LOCs).
  + Information/explanation of guarantees or other commitments to PSA.
  + Securities lending program (nature, size, reinvestment policies, etc.).
  + Separate accounts plan descriptions and/or policy forms as they relate to its securities lending program (Life/A&H).
* Investment Diversification
  + Planned asset mix and diversification strategies.
* Mortgages
  + Handling of foreclosed mortgage loans.
* BA Assets
  + Information regarding the liquidity of non-traditional investments to ensure that limitations in this area are understood.
  + Current Audited Financial Statements and other documents (partnership agreements, etc.) necessary to support the value of the insurer’s investment in partnerships and joint ventures.
  + Information necessary to support the value of significant other invested assets other than partnerships and joint ventures.
  + Current details on cash flows and returns for the different types of investments, especially hedge funds and private equity funds.
* RMBS, CMBS and LBaSS
  + Percentage distribution and amounts of each type of RMBS, CMBS and LBaSS held; planned amortization class (PAC), support bonds, interest only (IO) tranches, and principle only (PO) tranches to evaluate the level of prepayment risk in the portfolio.
  + Projected prepayment speeds on its RMBS portfolio and compare with historical prepayments, as well as the prepayment assumption at the time of purchase.

**Own Risk and Solvency Assessment (ORSA)**

Obtain and review the latest ORSA Summary Report for the insurer or insurance group (if available) to assist in identifying, assessing and addressing risks faced by the insurer.

If the insurer is required to file an ORSA or is part of a group that is required to file an ORSA,

* Determine whether the ORSA Summary Report analysis conducted by the lead state indicate any liquidity risks that require further monitoring or follow-up.
* Determine whether the ORSA Summary Report analysis conducted by the lead state indicate any mitigating strategies for existing or prospective liquidity risks.
* For relevant business types, determine whether the ORSA Summary Report analysis conducted by the lead state indicate any liquidity risks regarding catastrophic exposure and related mitigating strategies.

**Holding Company Analysis**

Obtain and review the holding company analysis work completed by the lead state to assist in identifying, assessing and addressing risks that could impact the insurer.

* Determine whether the Holding Company Analysis conducted by the lead state indicate any liquidity risks impacting the insurer that require further monitoring or follow-up.
* Determine whether the Holding Company Analysis conducted by the lead state indicate any mitigating strategies for existing or prospective liquidity risks impacting the insurer.

**Actuarial Filings, Including Asset Liability Matching (Life/A&H and Health)**

* Review of the Statement of Actuarial Opinion or other actuarial filings for any concerns regarding the adequacy of asset liability matching, cash flow stress testing and the sufficiency of assets to meet the business obligations of the insurer.
* If concerns are identified regarding overall liquidity of the asset portfolio, request a copy of the insurer’s asset-liability matching policy and/or liquidity stress testing/scenario analysis.

# Quarterly Liquidity Risk Assessment

The quarterly liquidity risk procedures are designed to identify the following. For additional guidance on individual procedure steps, please see the corresponding annual procedures discussed above.

**Insufficient Overall Liquidity (or Illiquid Assets are Significant)**

Procedures / Data

* Analyze the insurer’s liquidity position by reviewing the following metrics and data elements:
  + P/C: ratio of adjusted liabilities to liquid assets and the change from prior year
  + Life/A&H:
    - Ratio of capital and surplus plus AVR to total assets (excluding separate accounts)
    - Change in liquid assets from prior quarter-to-date or prior year-end
  + Health:
    - Ratio of liquid assets (excluding non-investment grade bonds) and receivables to current liabilities
    - Change in liquid assets from prior year-end
    - Ratio of working capital to total assets

Additional Procedures

* Review the liquidity ratio (P/C), liquidity (Life/A&H), and the ratio of total liabilities to liquid assets (Health) within the Financial Profile Report, and document any unusual fluctuations over the last five years.
* If concerns are identified regarding overall liquidity of the asset portfolio, identify and assess other sources of liquidity available to the insurer. (Or, request information from the insurer if necessary. See Additional Analysis and Follow-Up Procedures below).
* Assess the impact of market conditions through consideration of industry and economic events (i.e., news, industry analytics). Is the analyst aware of any market conditions that may threaten the liquidity of insurers’ investment portfolios (e.g., market dislocation or other events that could affect liquidity of assets classes such as structured securities, structured notes, Schedule BA assets and non-investment grade bonds).

**Exposure to Other Invested Assets (Schedule BA)**

Determine whether there are concerns due to the level of investment in Schedule BA Assets.

Procedures / Data

* Ratio of Schedule BA Assets owned to policyholders surplus (P/C) to net admitted assets (Life/A&H) and to capital and surplus (Health)
* Increase in Schedule BA Assets from the prior year-end, where the ratio of Schedule BA Assets to surplus is material

**Liquidity of Reinvested Collateral within the Securities Lending Program (P/C and Life/A&H)**

Determine if concerns exist regarding the materiality of securities lending activity and the nature of the reinvested collateral.

Procedures / Data

* Ratio of securities lending collateral reinvested to total assets
* Aggregate total collateral received

Additional Procedures

* Review the Quarterly Financial Statement General interrogatories, Part 1, #16 and Notes to the Financial Statements, Note #5 (if reported) to gain an understanding of the scope of the securities lending program and to understand how the cash collateral is reinvested.

**Exposure to Affiliated Investments**

Determine whether investments in affiliates are significant.

Procedures / Data

* Ratio of affiliated investments to policyholder surplus (P/C) and to capital and surplus (Life/A&H and Health)
* Change in total affiliated investments from the prior year
* Change in any category of affiliated investments from the prior year

Additional Procedures

* Review the results of the Holding Company Analysis completed by the lead state to determine if any concerns exist regarding affiliated entities.
* Review Quarterly Financial Statement, Notes to the Financial Statements, #10 and #14, if reported, to identify if the insurer is subject to any guarantees or other commitments to parent, subsidiaries, or affiliates (PSA). If the guarantee or commitment is material to the insurer, assess the nature of the agreement and the financial strength of the PSA.

**Exposure to Other Less Liquid Receivables (Health)**

Review and assess furniture, equipment, supplies, and EDP equipment.

Procedures / Data

* Ratio of admitted furniture, equipment and supplies to capital and surplus
* Change in the admitted balance of furniture, equipment and supplies from the prior year
* Ratio of admitted EDP equipment and software to capital and surplus
* Change in admitted EDP equipment and software from the prior year

**Negative (or Negative Trend in) Cash Flow from Operations**

Review cash flow from operations and determine if any concerns exist.

Procedures / Data

* Property/Casualty:
  + Ratio of net cash from operations to policyholders surplus (P/C) and the change from prior year-to-date
* Life/A&H:
  + Ratio of net cash from operations to capital and surplus and the change from prior year-to-date
  + Ratio of net cash from operations to premium income
  + Ratio of other cash provided (applied) to capital and surplus
  + Ratio of other cash provided (applied) to net cash from operations
  + Change in other cash provided (applied)
  + Ratio of net transfers to or from separate accounts to capital and surplus and the change from the prior quarter-to-date
* Health:
  + Ratio of net cash from operations to capital and surplus and the change from prior year-to-date
  + Ratio of net cash from operations to premium income
  + Ratio of benefits and loss related payments to premiums collected net of reinsurance

Additional Review Considerations

* Review the cash flow from operations to determine the underlying cause of the negative cash flow.
* Review the trend in net cash from operations for the past five years and note any unusual fluctuations or negative trends between years.

**Liquidity Strain of Surrender and Withdrawal Activity (Life/A&H)**

Determine whether concerns exist regarding the insurer’s surrender and withdrawal activity.

Procedures / Data

* Ratio of surrender benefits to net premiums
* Ratio of surrender benefits to capital and surplus
* Change in the ratio of surrender benefits to capital and surplus ratio

Additional Procedures

* Review Quarterly Financial Statement, Notes to Financial Statements, Note #32, if reported, to determine if the insurer has a material amount of annuity reserves withdrawable with minimal or no charge.
* Review the Quarterly Financial Profile Report to determine if there appears to be a negative trend in surrender activity over the past five quarters.
* If concerns exist, review the insurer’s plan descriptions and/or policy forms to better understand the types of plans offered and the specific policy withdrawal features and surrender charges.

**Significant Assessments Against Policy Benefits (Fraternal Societies Only)**

Assess the materiality of a Fraternal Society’s liens on policyholder benefits.

* For fraternal societies, did the society report outstanding assessments in the form of liens against policy benefits that have increased surplus? [General Interrogatories – Part 2 – #6.1]
* Review the ratio of total liens as a percentage of total current year surplus to assess the materiality of outstanding assessments.
* Determine if new assessments were imposed in the current year. Review any information the department has on the nature and duration of the liens [Quarterly Financial Statement, General Interrogatories – Part 2 – #6.2]