



To: Jim Hattaway, Chair of the Risk Focused Surveillance Working Group

From: NAIC Examination Unit Staff

Date: February 3, 2012

RE: Feedback from Interested Parties on Risk Focused Examinations

At the request of the Risk Focused Surveillance Working Group (RFSWG), a survey was distributed to interested parties of both the RFSWG and the Financial Condition (E) Committee. A total of 26 different responses were received including 21 companies, 1 trade organization (representing responses from approximately 150 legal entities), 1 group of interested parties (representing responses from 414 legal entities spanning multiple lines of business), and 3 contractors. This memo summarizes the responses received to each of the 11 survey questions.

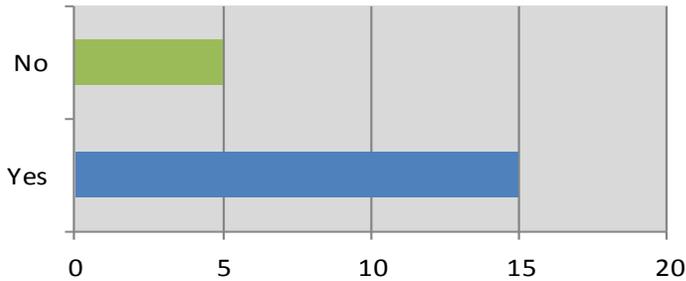
1. What impact has the new risk focused process had on the financial examinations performed on your organization?

A number of respondents indicated that the new process helps the examiners focus on the most significant risks including those that are more forward looking. When done well, this shifted much of the examination time from reviewing small details of transactions to more strategic issues. However, many responses noted that while the process began in a risk focused manner by identifying significant and forward looking risks, examiners often reverted back to a more substantive approach in the latter stages of the examination. Because of this, there were often minimal increases in efficiency so that, on average, the exams were more time consuming than under the previous approach.

Many respondents noted that the new approach required more involvement of C-level individuals at the company which often helped increase the examiner's understanding of the company, but made it more difficult to coordinate with their already demanding schedules.

One area where efficiencies were noted was when existing documentation (internal/external audit workpapers, SOX/MAR documentation, etc.) was utilized by the examiner. The leveraging of this existing information was a theme throughout the survey with many respondents expressing the importance of using this information correctly to become more efficient and effective. In some cases the respondents felt the examiner used the existing information very well, but in many cases, the respondents felt that better use of this information would have led to a more efficient examination.

2. Do you believe that examiners have gained a better understanding of your organization and its risks through the risk focused examination process? Please explain.



Many of the responses, whether they responded yes, no, or undecided, indicated that the answer depends largely on the examiner's experience and knowledge of the industry. Examiners who gained background knowledge prior to starting key elements of the exam, were able to utilize the new approach to gain an even better understanding of the company.

3. What aspects of the risk focused approach do you consider the most significant improvements of the new process and why?

The most common improvement noted in the survey was the increased reliance on internal/external audit workpapers as well as the ability to use SOX and MAR documentation. When this was done correctly, there were many benefits to both the examiners and the company. Previously, much of the work done by examiners was duplicative of work already performed by an internal/external auditor. When this duplicative work is reduced and existing work is utilized instead, more resources can then be more focused on the most important and risky areas of the company.

This leads to the next two most commonly identified improvements under the new approach which are the examiners' ability to focus on the greatest risks to a company and the examiners' ability to gain a better understanding of the company. These two improvements are directly linked since a better understanding allows the examiner to better identify the significant risks and therefore allocate resources accordingly.

A small number of respondents indicated that there is no discernible improvement from the previous approach.

4. What aspects of a financial examination are the most challenging to your organization?

The most common challenge for the company is the time required of company personnel to accommodate the requests of the examiners. The examiner does not often allow much flexibility when scheduling and requests for questionnaires and data are not given with enough advance notice.

The other most common challenge noted was a lack of examiner understanding of the company. This was most evident during the C-level interviews as well as the requests for data. When the examiner lacks a basic understanding of the company, it is difficult for them to perform effective interviews and contributes to the time required of staff and executives as mentioned above. Throughout the survey there seemed to be a large variation in the knowledge of the examiners

that the responding companies worked with. In addition to lacking knowledge of the company, the respondents noted that the examiners often lacked an understanding of the risk focused approach. This was evident when the focus of the exam did not appear to be the most significant risks identified during the planning process. However, respondents indicated that working with more experienced examiners reduced the number of challenges experienced in this area.

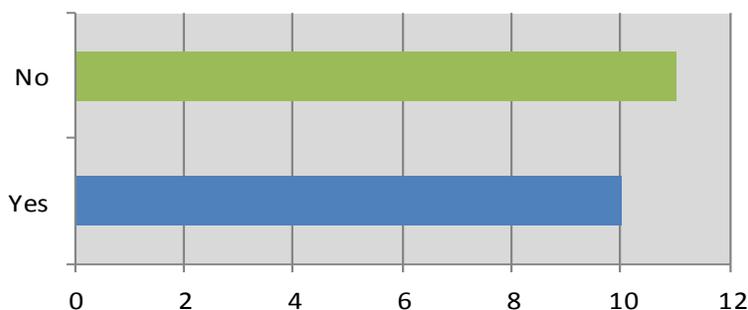
Other challenges noted included issues when exams were not effectively coordinated with other states (duplication of work, inconsistent approaches), lack of secure methods for transmitting data and budget concerns.

5. How can examiners be more effective in performing interviews of senior executives during a risk-focused examination?

There were multiple recommendations echoed throughout the responses to this question as well as in the responses to other questions regarding interviews. All of the input regarding interviews is summarized here as follows:

- Examiners should obtain a basic understanding of the company prior to conducting the interview. This would create a more efficient interview and make a better use of both the examiner and the interviewee's time.
- Examiners should provide a written agenda ahead of time. This would enable the interviewee to be more prepared and provide more valuable responses. This could also enable the interviewee to bring supporting documents to the meeting to decrease the follow-up time required for both parties.
- Questions should be tailored to focus specifically on the company under examination. Questions that do not line up with the objective of the interview or the business of the company add unnecessary time and can detract from the relevant information communicated.
- Examiners should provide sufficient lead-time when scheduling interviews and be sensitive to the timing of when these are conducted. If flexible meeting dates and times are offered, the interviewee can be better prepared and may provide more valuable information.
- Reduce the number of examiners attending the interview to only those who are necessary. Too many examiners can be intimidating and creates budget concerns about whether the examiner's time is being allocated appropriately.
- Examiners should schedule the interviews as early as possible in order to gain the maximum benefit from these executive level individuals when assessing risks and planning the remainder of the exam.

6. Do you believe that examiners focus resources on the more risky areas? If not, please explain how resources could be redirected to those areas.



Many answers indicated that toward the beginning of the exam there appeared to be an attempt to identify and focus on risks, but when detail testing was performed there were requests made and significant time spent on areas that did not appear to match up with the original risks that were discussed. Additionally, many of the yes responses referred to reliance on existing audit work or SOX/MAR documentation while many of the no responses indicated that if the examiner had utilized existing audit work or SOX/MAR documentation during planning, risk areas may have been more accurately identified and resources redirected.

7. How can the efficiency of risk focused examinations be improved?

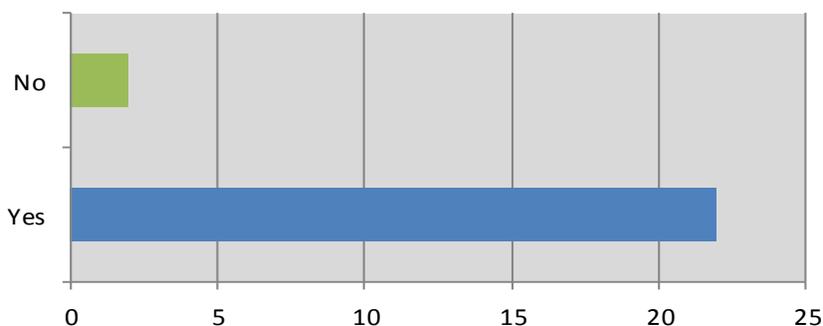
The three most common responses to increase efficiency were more reliance on work performed by internal audit/external audit, SOX/MAR documentation, etc., more reliance on other state's work or prior exams when applicable, and better management of the planning phase. Better management of the planning phase includes adequate time to complete forms, send detail request lists ahead of time, revise request lists once risks have been determined and conduct as much work as possible prior to coming on site. Throughout all of these responses was the idea that if only the areas of highest risk were reviewed then unnecessary time spent on immaterial items could be eliminated and efficiency would be improved.

Other recommendations included ensuring there is a secure way to transfer electronic files, providing more training on the risk focused approach to promote consistency and proper application of risk focused concepts and allowing for more oversight by the supervisor during the exam.

8. How can information provided by your organization's risk management function be utilized in a risk-focused examination?

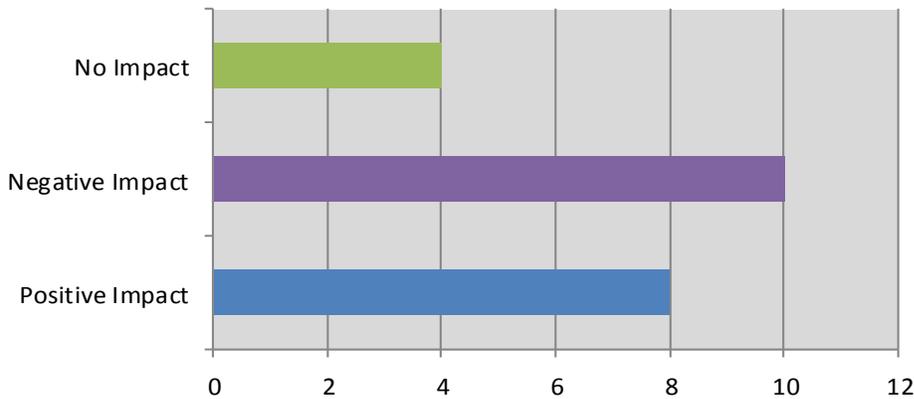
Overall the responses indicated that the companies believe information from the risk management function to be very beneficial to the examiner when identifying and assessing risk as required by the risk focused approach. Utilizing this information that has already been accumulated by the company can go a long way to promote efficiency during an exam. In order to get the most value from this information, the respondents recommended interviewing someone from the risk management function and obtaining an overview of the information this function may provide during the planning phase. This will allow the examiner to scope out low risks and focus on high risks.

9. Do you believe the "specialists" (actuarial, information technology controls review, investments, reinsurance) review during an examination is in line with the new risk-focused approach? If not, please explain.



Respondents indicated that the amount of oversight by the examiner in charge and the ability of the specialist to coordinate the work with the exam team can influence how effective the specialist is in performing the risk focused approach. The downside of using a specialist was when work duplicates what has already been performed by the external auditor or consultant and when the specialist did not seem to focus on the most significant risks, which was most often noted in reference to the work done by actuaries.

10. Is there an impact on examinations if a contract firm is utilized to perform the examination (or a portion of an examination) on behalf of a state?



Those that indicated using a contract examiner had a positive impact on the examination cited the fact that deadlines were more often met and exams were completed in less time. Often the contract examiners were more organized and were able to better manage the work flow which increased the efficiency of the exam from a time perspective. Some respondents noted that contract examiners had a better understanding of how to identify and assess risk and were more objective during that process.

Those that indicated using a contract examiner had a negative impact on the examination overwhelmingly cited increased cost as a primary reason. Several respondents questioned whether the contractors have an economic incentive to draw out the examination and whether they were appropriately supervised by the state. In many cases, respondents noted that the increased costs did not often come with any added value. Some respondents noted that contract examiners seemed to lack knowledge regarding state laws, company background and how to appropriately follow the risk focused approach. Responses also indicated a lack of communication between the contractor and the state that decreased efficiency and increased time required by company personnel. Respondents noted that increased oversight by the state is necessary throughout the examination process in order to monitor and manage these issues.

11. What other suggestions can you make to improve the overall quality of the financial examination process?

Many of the answers to this question referenced back to previous suggestions and are included in the summary of the related question. Additional comments are as follows:

- Communicate with the company the risk areas that have been identified for further investigation during planning. This can help the company better allocate resources to

those areas. The company can work with the examiner as each phase is completed to schedule the appropriate amount of time to conduct the work for each risk and schedule the right people to address examiner questions.

- Consider sharing the matrices with the company throughout the process to help align the risks identified by the examiner with the risks the company faces.
- Communicate to the company risks that are identified and gaps in mitigating those risks. The external opinion given by the examiner can be beneficial to a company that is trying to better assess and manage their risks. It would also give them the chance to correct any issues or fill any gaps going forward.
- Continue to be mindful of the importance of confidentiality of company information. This applies when using contractors and specialists, drafting exam reports or other documents that are publicly available, transmittal of data, etc.
- The risk focused approach requires examiners to reach outside of the traditional accounting role and exercise critical thinking to identify and test risks in many areas that include overall business strategy, underwriting processes, investment strategy, etc. Examiners with the ability to take on this new role are necessary for the success of this approach.
- Make sure to tailor items in the Examiners Handbook such as interview questions, planning questionnaires, risks taken from the repositories, etc. to fit the company under examination. When these items are taken directly from the Handbook with no modifications, the approach begins to work more like a checklist approach rather than a risk focused approach.
- Some companies have indicated that the number of risks examiners identify during an exam is far too large and can actually distract from the most significant risks. A concerted effort should be made to implement changes expressed by Superintendent Torti in his May 28, 2011 letter to the Financial Condition (E) Committee regarding reduction in Financial Statement verification.