

FINANCIAL REGULATION STANDARDS AND ACCREDITATION (F) COMMITTEE

Financial Regulation Standards and Accreditation (F) Committee Oct. 18, 2010, Minutes

Memo from Capital Adequacy (E) Task Force dated Oct. 6, 2010, Regarding Significant Elements for the Risk-Based Capital for Health Organizations Model Act #315 (Attachment One)

Memo from Financial Examiners Handbook (E) Technical Group dated Oct. 6, 2010, Regarding Revisions to the Examination Planning Memorandum (Attachment Two)

Memo from Financial Analysis Handbook (E) Working Group dated Aug. 15, 2010, Regarding Recommendation for Part B Financial Analysis Review Team Guidelines Enhancements Regarding Financial Analysis Standards (Attachment Three)

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Financial Regulation Standards and Accreditation (F) Committee
Orlando, FL
October 18, 2010

The Financial Regulation Standards and Accreditation (F) Committee met in Orlando, FL, Oct. 18, 2010. The following Committee members participated: Joseph Torti, III, Chair (RI); Leslie A. Newman, Vice Chair, represented by Larry Knight (TN); Linda S. Hall represented by Gloria Glover (AK); Thomas R. Sullivan represented by Kathy Belfi (CT); Susan E. Voss represented by Jim Armstrong (IA); Joseph G. Murphy represented by John Turchi (MA); Elizabeth Sammis represented by Neil Miller (MD); Mary Jo Hudson represented by Dale Bruggeman and Bill Harrington (OH); Kim Holland represented by Darren Ellingson (OK); Scott H. Richardson represented by Linda Haralson (SC); Mike Geeslin represented by Danny Saenz (TX); Neal T. Gooch represented by Jake Garn (UT); and Alfred W. Gross represented by Doug Stolte (VA).

1. Discuss Comments Received on and Consider Adoption of Revisions to the “Use of Specialists—Computer Audit Expertise Guidelines”

Superintendent Torti discussed a July 26 Committee referral from the Information Technology (IT) Examination (E) Working Group that discusses revisions to the *Financial Condition Examiners Handbook* to update the IT review process (including Exhibit C) so it corresponds to the new risk-focused surveillance approach to financial examinations. The Working Group proposed revisions to the “Computer Audit Expertise Guidelines” under the Use of Specialists standard. At the Summer National Meeting, the Committee discussed this referral and voted to release the proposed revisions for a 30-day comment period. No comment letters were received. Mr. Garn made a motion, seconded by Ms. Belfi, to adopt the revisions to the “Computer Audit Expertise Guidelines” under the Use of Specialists standard, effective Jan. 1, 2011. The motion carried unanimously.

2. Discuss Comments Received on and Consider Adoption of New Part A Items for Risk Retention Groups

Superintendent Torti said that, at the 2008 Winter National Meeting, the Committee adopted Part A: Laws and Regulations standards for risk retention groups (RRGs) effective Jan. 1, 2011. The Risk Retention Group (E) Task Force’s deliberations on the Part A standards took approximately five years. During that time, some of the NAIC model laws and regulations were revised, but the revisions were not reviewed by the Task Force until 2009 and 2010. A July 28 memo from the Task Force details those Part A standards that changed and includes the Task Force’s recommendations on whether these should be applicable to captive RRGs. At the Summer National Meeting, the Committee discussed the referral and voted to release it for a 30-day comment period. No comment letters were received. Mr. Armstrong made a motion, seconded by Ms. Glover, to adopt the new Part A standards for captive RRGs, effective Jan. 1, 2012. The motion carried unanimously.

3. Discuss Comments Received on, and Consider Additional Exposure Period for, the *Risk-Based Capital for Health Organizations Model Act* (#315)

Superintendent Torti said a March 28 memo from the Capital Adequacy (E) Task Force recommends that the *Risk-Based Capital for Health Organizations Model Act* (#315) become an accreditation standard. At the 2009 Winter National Meeting, the Task Force unanimously agreed that Model #315 should be an accreditation standard, and, at the Spring National Meeting, the Financial Condition (E) Committee adopted the Task Force’s recommendation. An Oct. 6 memo (Attachment One) from the Task Force details which key provisions of Model #315 should be considered as significant elements for accreditation. At the Summer National Meeting, the Committee discussed the referral and voted to release the proposed revisions for a 30-day comment period. No comment letters were received. Mr. Armstrong made a motion, seconded by Mr. Knight, to release Model #315 for a one-year comment period beginning Jan. 1, 2011.

4. Discuss Comments Received on, and Consider Adoption of Revisions to, Guideline #2 in the “Appropriate Depth of Review” Standard

Superintendent Torti said a July 27 memo from NAIC staff recommends that the Part B: Financial Analysis “Appropriate Depth of Review” standard be updated to include the correct financial solvency tool titles and to require the analysis of a domestic insurer’s Actuarial Opinion Summary (AOS). The *Property and Casualty Actuarial Opinion Model Law* (#785) became an accreditation standard effective Jan. 1, 2010, and requires an insurer to annually file with its domiciliary regulator an AOS. The *Property/Casualty Financial Analysis Handbook* checklists now include guidance on analyzing the AOS, and all accredited jurisdictions will require submission of this filing beginning Jan. 1, 2011. At the Summer National Meeting, the Committee discussed the memo and voted to release the proposed revisions for a 30-day comment period. No comment

letters were received. Mr. Armstrong made a motion, seconded by Mr. Garn, to adopt the revisions to the “Appropriate Depth of Review” standard, effective Jan. 1, 2011. The motion carried unanimously.

5. Discuss Comments Received on, and Consider Adoption of Revisions to, the “Scheduling of Examination” Standard for Removal of the “Zone Exam” Concept

Superintendent Torti said a July 7 memo from the Financial Examiners Handbook (E) Technical Group, discusses revisions to the *Financial Condition Examiners Handbook* to remove the “zone exam” concept. The NAIC association “zone” examination concept was originally intended to promote coordination between the states in conducting financial examinations. The revisions to the Handbook removed all references to the “zone examination” concept and replaced that with language discussing “multi-state” examinations. As a result of these revisions, all multi-state examinations would now be required to be called via the NAIC Examination Tracking System for accreditation purposes.

The Technical Group recommended revising the “Scheduling of Examinations” standard to remove the distinction between multi-state and zone exams, as was previously done in the Handbook. At the Summer National Meeting, the Committee discussed the memo and voted to release the proposed revisions for a 30-day comment period. No comment letters were received. Mr. Bruggeman made a motion, seconded by Mr. Knight, to adopt the proposed revision to one of the “Scheduling of Examinations” guidelines, effective Jan. 1, 2011. The motion carried unanimously.

6. Discuss Comments Received on, and Consider Adoption of, Revisions Proposed by the Survey Results (F) Subgroup

Superintendent Torti said one of the recommendations in the Hamm Report was to conduct a survey to obtain state feedback regarding which current accreditation standards and review team guidelines are valid measures of acceptable performance in financial regulation. NAIC staff conducted the survey during summer 2009 and, based on the responses, staff prepared a memo that included seven recommendations of possible actions the Committee could consider taking regarding the current standards and review team guidelines. At the 2009 Winter National Meeting, the Committee voted to form the Survey Results (F) Subgroup to consider the seven staff recommendations, in addition to reviewing the current guidance related to risk-focused examinations. A July 22 memo from the Subgroup discusses the seven staff recommendations, as well as the Subgroup’s deliberations and conclusions regarding those items. In addition, the Subgroup included proposed revisions to the current review team guidelines for risk-focused examinations. At the Summer National Meeting, the Committee discussed the memo and voted to release the Subgroup’s proposed revisions for a 30-day comment period. No comment letters were received. Mr. Knight made a motion, seconded by Mr. Garn, to adopt the Subgroup’s proposed recommendations and revisions to the review team guidelines, effective Jan. 1, 2011. The motion carried unanimously.

Superintendent Torti said the Committee received an Oct. 6 referral (Attachment Two) from the Financial Examiners Handbook (E) Technical Group in response to recommendations sent by the Subgroup to the Technical Group after the Summer National Meeting. The recommendations proposed enhancements to the *Financial Condition Examiners Handbook* regarding the timing of the review of the exam planning memorandum. As recommended by the Subgroup, the examination planning memo will now be required to be completed and signed off by the appropriate reviewer at the end of Phase 2. The Handbook will still require separate approval at the point of detail testing being established via a separate sign-off by the supervisor. The Technical Group also proposed suggested revisions to some of the current review team guidelines. Mr. Garn made a motion, seconded by Mr. Turchi, to release the referral and proposed revisions for a 30-day comment period. The motion carried unanimously. If no comment letters are received during that period, it is anticipated the Committee will vote on adoption of the revisions during an interim conference call or via e-mail so that they may become effective Jan. 1, 2011.

7. Discuss Comments Received on, and Consider Adoption of, Revisions Regarding Group Holding Company Analysis

Superintendent Torti said that an Aug. 14 memo from the Group Solvency Issues (EX) Working Group suggests the Committee adopt new holding company analysis review team guidelines for 2011 annual statement implementation. The current analysis guidelines require holding company filings to be reviewed, but do not express the extent of the expectations on the degree of analysis taken with such documents. In response to this, as well as a variety of other similar efforts all related to group-wide supervision, the Working Group proposed updates to the “Appropriate Depth of Review” and “Documented Analysis Procedures” standards to provide more defined guidance regarding holding company analysis. At the Summer National Meeting, the Committee discussed the memo and voted to release the proposed revisions for a 30-day comment period. No comment letters were received. Mr. Saenz made a motion, seconded by Mr. Garn, to adopt the proposed revisions to the analysis review team guidelines, effective Jan. 1, 2012. The motion carried unanimously.

8. Discuss Referral from the Financial Analysis Handbook (E) Working Group Regarding Proposed Enhancements to the Review Team Guidelines

Superintendent Torti said that an Aug. 15 memo (Attachment Three) from the Financial Analysis Handbook (E) Working Group proposed revisions to the review team guidelines in order to clarify and incorporate the risk-focused surveillance approach and certain terminology currently documented in the *Financial Analysis Handbooks*. Mr. Knight made a motion, seconded by Mr. Garn, to release the proposed revisions to the financial analysis review team guidelines for a 30-day comment period. The motion carried unanimously. If no comment letters are received during that period, it is anticipated the Committee will vote on adoption of these revisions during an interim conference call or via e-mail so that they may become effective Jan. 1, 2011.

9. Financial Analysis Handbook (E) Working Group's Response to the Form A Procedures Referral

Superintendent Torti said that, at the 2009 Summer National Meeting, the Committee voted to adopt Part D standards related to company licensing and change in control. One of the new Part D standards is "Scope of Procedures for Form A Filings." In summary, this standard requires that an insurance department have documented procedures for the review of Form A filings. On Aug. 25, the Committee sent a referral to the Financial Analysis Handbook (E) Working Group recommending that the group review the new Part D standards related to Form A filings and make any appropriate updates to the Form A checklist within the *Financial Analysis Handbooks*. In response to the referral, the Working Group drafted revisions to the Form A procedures chapter of the Handbook. After a 30-day comment period, the revisions were adopted by the Working Group on Oct. 8.

Having no further business, the Financial Regulation Standards and Accreditation (F) Committee adjourned.

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MEMORANDUM

TO: Superintendent Joseph Torti, III
Financial Regulation Standards and Accreditation (F) Committee

FROM: Lou Felice, Chair
Capital Adequacy (E) Task Force

DATE: October 6, 2010

RE: Significant Elements for the Risk-Based Capital for Health Organizations Model Act (#315)

At the Aug. 14 meeting of the Financial Regulation Standards and Accreditation (F) Committee, Superintendent Torti requested that the Capital Adequacy (E) Task Force provide guidance regarding the items in the Risk-Based Capital for Health Organizations Model Act (#315) that should be identified as significant elements for accreditation purposes. These would be the key provisions of the model that should be specifically required for accreditation. These provisions would not apply to single state and other entities that are exempted from application of the risk-based capital (RBC) model act.

Below are the significant elements for accreditation identified by the Capital Adequacy (E) Task Force based on the significant elements already identified for the Risk-Based Capital for Insurers Model Act (#312):

- Definitions similar to those in Section 1
- Provisions to RBC Reports similar to Section 2
- Definitions of Company Action Level Event and processes regarding such similar to Section 3
- Definitions of Regulatory Action Level Event and processes regarding such similar to Section 4
- Definitions of Authorized Control Level Event and processes regarding such similar to Section 5
- Definitions of Mandatory Control Level Event and processes regarding such similar to Section 6
- Provisions for Hearings similar to those in Section 7
- Confidentiality and Prohibition on Announcement provisions similar to those in Section 8
- Supplemental provisions similar to Section 9
- Provisions for foreign insurers similar to Section 10
- Severability provisions similar to Section 12
- Notice provisions similar to Section 13

Any questions regarding the significant elements may be directed to me at 212-480-5061, or to Dan Swanson (NAIC) at 816-783-8412.

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To: Joseph Torti, III, Chair, Financial Regulation Standards and Accreditation (F) Committee

From: Al Bottalico, Chair, Financial Examiners Handbook (E) Technical Group

Date: October 6, 2010

Re: Revisions to the Examination Planning Memorandum

In summer 2010, the Survey Results Subgroup (Subgroup) of the Financial Regulation Standards and Accreditation (F) Committee (F Committee) sent recommendations to the Financial Examiners Handbook (E) Technical Group (Technical Group) for proposed enhancements to the Financial Condition Examiners Handbook. The Technical Group reviewed the recommendations and made appropriate revisions.

While a preliminary response was previously communicated to F Committee, substantial revisions have now been made to the Handbook in relation to the timing of review of the exam planning memorandum. As recommended by the Subgroup, the examination planning memo will now be required to be completed and signed off by the appropriate reviewer at the end of Phase 2 of the examination process, not once detail testing has been established for Phase 5 as previously required. The Handbook will still require a separate sign-off at the point of detail testing being established, but this will be accomplished through a separate sign-off in the examination file.

With the timing change regarding the completion of the exam planning memo, the Technical Group also adopted substantial revisions to the contents within the memo. To promote uniformity, the Technical Group would like to recommend revisions to the Review Team Guidelines in accordance with these changes to the Handbook. I ask that the F Committee please consider the tracked changes provided with this referral.

Thank you for your attention to this matter. If you have any questions regarding this referral, please contact me or NAIC staff member Mike Sindel.

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Exhibit 2: Subgroup Consensus on Revisions to the Review Team Guidelines for Risk-Focused Examinations

Included below are the current Review Team Guidelines (the Guidelines) for use with examinations performed using the risk-focused approach. The tracked changes are those revisions the Subgroup agrees should be made to the Guidelines to more closely tie them to the guidance included in the *Financial Condition Examiners Handbook*.

2. Financial Examinations

a. Sufficient Qualified Staff and Resources

No suggested changes

b. Communication of Relevant Information to/from Examination Staff

No suggested changes

c. Use of Specialists

No suggested changes

d. Appropriate Supervisory Review

Standard

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

Guidelines for Supervisory Review of Workpapers

- 1) All workpapers, including work performed by the EIC, should receive at least one level of supervisory review. In addition, work of specialists should be reviewed by the EIC for familiarity and understanding. The reviewer should be looking to see that the specialists' reports and, if necessary, workpapers evidence all procedures that are expected to be performed. In addition, the workpapers should be consistent with the examiner's conclusions and the examination report.
- 2) Supervisory review should be evidenced by sign off and dating by the reviewer. Supervisory sign-off and dates on every single workpaper is not required.
- 3) Supervisory review should be timely in nature.
 - Supervisory review of pPlanning (Phases 1 and 2) should be documented by a reviewed of the Examination Planning Memorandum, as well as a review of the

risk matrices or similar documents before the applicable substantive test work begins in Phase 3. A review of planning should include a review of the:

- Identification of key and sub-activities
 - Identification and assessment of inherent risks
 - ~~Identification and evaluation of risk mitigation strategies/controls~~
 - ~~Determination of residual risk~~
 - ~~Established substantive examination procedures~~
- Supervisory review of planning Phases 3, 4 and the first part of Phase 5 (establishing detail testing to be performed) should be documented by a review of the Examination Planning Memorandum, as well as a review of the risk matrices or similar documents and any associated coaching notes or correspondence before the applicable substantive test work begins. This should include a review of the:-
- Identification and evaluation of risk mitigation strategies/controls
 - Determination of residual risk
 - Established detail examination procedures

~~(Drafting Note: A referral has been sent to the Financial Examiners Handbook (E) Technical Group requesting that it discuss the timing of when the examination planning memo should be drafted and the related supervisory review should occur. For many examinations, a good portion of the examination has been completed by the end of Phase 4/beginning of Phase 5, and it may not make sense to wait until then to require supervisory review of the planning memo. Perhaps it would make more sense to change this to some other time such as the end of Phase 2. If the Technical Group adopts revisions to its Handbook guidance, this guideline will need to be updated accordingly. NAIC staff will monitor the work of the Technical Group and will advise the Committee of any further revisions.)~~

- Supervisory review of workpapers should occur within a reasonable period after completion of the item being examined (generally 2-4 weeks).
- 4) Supervisory review should ascertain whether the form of examination workpapers is consistent with Department standards.
- 5) Supervisory review should be an in-depth and challenging review of the examiner's findings. The occurrence and sufficiency of supervisory review may be verified through discussions with Department staff, including but not limited to, the EICs. The Department may demonstrate in-depth and challenging review by maintaining supervisory review notes. Regardless of whether supervisory review notes are kept; however, the supervisory review shall be presumed sufficient if the examination procedures appear to be complete and no material matter remains unaddressed.

Guidelines for Supervisory Review of Examination Reports

The examination report should be reviewed by at least one person other than the preparer. The commissioner or the commissioner's designee should approve the report prior to final issuance.

e. Use of Appropriate Guidelines and Procedures

Standard

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

General Guidance: The Department should demonstrate that examinations have been generally conducted in accordance with the NAIC *Financial Condition Examiners Handbook*. Specifically, documentation should support conclusions reached in determining the residual risks. However, because the risk-focused approach permits substantial examiner judgment in the determination of risk within a company, as well as a determination of the type and number of examination procedures that are performed, the conclusion itself shall not be subject to review under this guideline. Examination procedures should produce reports of examination, which provide information needed by regulatory personnel involved in the admission and regulation of companies as well as specific information needed for any disciplinary or other regulatory action.

Guidelines

- 1) A risk-based approach should be utilized in establishing priority of accounts or operational areas. The risk-based approach should include the following seven phases:
 - Phase 1 – Understand the company and identify key functional activities to be reviewed
 - Phase 2 – Identify and assess inherent risk in activities
 - Phase 3 – Identify and evaluate risk mitigation strategies
 - Phase 4 – Determine residual risk
 - Phase 5 – Establish/conduct exam procedures
 - Phase 6 – Update prioritization and supervisory plan
 - Phase 7 – Draft examination report and management letter based on findings

The examination approach may be documented in a variety of ways; however, the examiner should prepare a Risk Assessment Matrix, or substantially similar document including each of the seven phases listed above, as the central location for the documentation of risk assessment. The Risk Assessment Worksheets included within the NAIC *Financial Condition Examiners Handbook* are optional tools available to supplement the Risk Assessment Matrix.

For companies without extensive risk mitigation strategies/controls or for situations in which the examiner determines that it would not be cost-effective or efficient to

perform control testing, control testing may not be required prior to the examiner's ultimate determination of residual risk. However, even in those instances, the examiner should still follow the seven-phase examination process, including documenting an understanding of controls. Rather than testing controls, the examiner may assess an overall control rating of "weak" for the identified risks.

- 2) A memorandum should be prepared that summarizes the examination planning process. The memorandum should adequately discuss, but is not limited to, the following:

- ~~Results of the risk-focused surveillance approach~~
- ~~(Drafting Note: This item may need to be clarified based on the results of the referral made to the Financial Examiners Handbook (E) Technical Group.)~~ Scope and objectives of the examination
- Materiality assessment
- Results of analytical review
- ~~Results of IT function assessment, including work by IT examiners on Exhibit C~~ Review
- Corporate Governance assessment
- Results of the audit function assessment (internal and external) including review of external auditor's workpapers and reports
- Summary of key activities selected
- Scope of prospective risk assessment procedures to be performed
- Intended Reliance on work completed by auditors and accredited states
- ~~Review of independent auditor's workpapers and reports~~
- Exam Staffing and time budgets
- Management assessment
- ~~Results of the Board of Directors assessment~~

- 3) The examiner must prepare examination documentation in sufficient detail to provide a clear understanding of the work performed, the exam evidence obtained and its source, and the conclusions reached. All work performed should be properly referenced from the Risk Assessment Matrix or substantially similar document to the TeamMate steps and/or workpaper(s) where the examination and analysis were performed. Such steps and/or workpapers should fully document work performed and should include the initials and date of the preparer. Independent auditor, internal audit and company self-assessment work, including Sarbanes-Oxley compliance work, should be utilized and documented in all examinations where appropriate. However, the examiner must exercise professional judgment in utilizing the work of the independent auditor, internal audit function and other company self-assessments as well as in developing examination procedures. Retesting the independent auditor's work depends on the circumstances and is a matter of professional judgment.



To: Financial Regulation Standards and Accreditation (F) Committee

From: Roger Peterson (WI), Chair of the Financial Analysis Handbook (E) Working Group

Date: August 15, 2010

RE: Recommendation for Part B. Financial Analysis Review Team Guidelines Enhancements Regarding Financial Analysis Standards

The Financial Analysis Handbook Working Group (FAHWG) of the Examination Oversight (E) Task Force is charged with maintaining the *NAIC Financial Analysis Handbook*. During the Working Group's August 10, 2010 conference call, the Working Group unanimously adopted revisions to the Part B - Financial Analysis Review Team Guidelines to be referred to the Financial Regulation Standards and Accreditation (F) Committee (FRSAC). The motion was ratified by the Task Force on August 15, 2010. The recommendations are made in response to the June 10, 2010 referral from the Survey Results Subgroup of the FRSAC to consider whether any additional guidelines, or revisions to existing guidelines, would be appropriate. Overall, the Working Group's revisions to the guidelines serve to clarify and incorporate certain risk-focused surveillance approaches and terminology currently documented within the *NAIC Financial Analysis Handbook*. The recommendations are attached.

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