



Date: June 27, 2014

Re: RRC Response to NAIC: Required Elements Chart for Financial Examiner Handbook

Background

In Fall 2013 the Risk-Focused Surveillance (E) Working Group sent a referral to the Financial Examiners Handbook (E) Technical Group requesting that the Technical Group consider revisions to the Handbook to maintain consistency with the adoption of critical risk categories. Specifically, the Working Group requested that the Technical Group consider revisions to the examination repositories, the examination objective and the various elements required for inclusion in the examination report. The Technical Group has addressed the examination objective of this referral through its recent exposure and adoption of related Handbook guidance. The Technical Group is also currently working toward revising the examination repositories to be in alignment with the critical risk categories. To address the required elements of the examination report, the Technical Group formed the Financial Examination Report (E) Subgroup.

Some of the current required elements of the examination report may be perceived as unnecessary and/or irrelevant given the recent changes to the risk-focused examination approach. Additionally, recent peer review sessions have identified numerous required elements that do not appear to add value, are easily obtained through other sources, or may be redundant. Various regulators, including those attending the peer review, expressed concern resources were being devoted to completing work that was performed solely for the purpose of including the conclusion of that work in the examination report.

As discussed on the conference call, the goal of this project is to revise and limit the current required elements to contain only the minimum necessary for reporting purposes. The summary of requirements outlined by the Model Law on Examinations (available in the "Related Documents and Resources" at http://www.naic.org/committees_e_examover_fer_sg.htm) may help guide you in identifying elements that can be removed. As you go through this project, consider what purpose the examination report serves, the intended audience of the examination report and what elements may be driving unnecessary examination work.

Assignment

Responses should be provided to Bailey Henning (bhenning@naic.org) no later than June 27th.

Part I: Elements for inclusion in body of exam report

Each element listed in the left column of the table below is currently included in the *Financial Condition Examiners Handbook* as a required element to be included in the body of the examination report. As mentioned above, the purpose of this project is to reduce this listing to include just the "minimum" requirements for elements to be included in the body of the examination report. In the right column of the table, please provide a rationale for those items which you determine should be included as a minimum required element for inclusion in the body of the exam report. If a rationale is not provided in the right column, it will be assumed that your recommendation is to remove that particular item from the required elements. Keep in mind that examiners would be allowed to include other items in the body of the examination report, even if they are not explicitly required by the Handbook. Note: Consideration for the inclusion of Financial Statements and any additional language that may be necessary will be addressed separately (see part II below).

Element currently required to be in body of exam report	Rational for keeping this element Risk & Regulatory Consulting (RRC) Comments:
Summary of significant findings (material adverse findings, significant non-compliance findings, material changes in financial statements, update on other significant regulatory information disclosed in the previous examination).	Retain – this is a critical element that should be communicated in an exam report – a reader would be interested in this.
Any subsequent events (any significant subsequent event determined by the examiner).	Retain – a reader would be interested in this. It would be helpful to have more guidance to the examiner on what constitutes a reportable subsequent event that should be mentioned in a report vs. others that could be omitted.
Company history (dividends and capital contributions, mergers and acquisitions).	We do not believe that including company history going back to the beginning of time is necessary.
Corporate records (minutes of meetings of stockholders, directors, and committees review for compliance and support).	Do not include unless there are issues with the meetings or associated minutes that constitute examples of corporate governance issues that should be communicated and/or addressed (if so, these types of instances should tie to a specific finding).
Management and control, including corporate governance (list of directors, senior officers and principal internal committee members, with name, title and location). Also, if the insurer is a member of a holding company, include an organization chart, summary of cost-sharing agreements and any significant regulatory information concerning the parent, subsidiaries and affiliates. As exam reports should only contain findings of fact, the corporate governance assessment(s) is considered subjective and does not lend itself for inclusion in the report.	<p>List of directors, etc. – do not include because this is information available on the jurat page of the Annual Statement.</p> <p>Org chart – is included in Exhibit Y, so not necessary.</p> <p>Cost Sharing Agreements/info concerning PSA – Recommend deleting.</p> <p>Regarding all of the above areas: if issues exist, these obviously should be covered under the findings and observations.</p>
Fidelity bonds and other insurance (amount of such bonds and whether they meet the NAIC suggested minimum outlined in Exhibit R; a comment concerning other coverages should be sufficient, unless there is reason to be more specific).	Only include if there is a specific examination finding.

Pensions, stock ownership and insurance plans (types of plans offered by the company, omitting details concerning eligibility requirements and benefits available to company employees and agents, whether the provision was made in the financial statements for company obligations under such plans).	Only include if there is a specific examination finding.
Territory and plan of operation (jurisdictions in which the company is licensed).	This information can be obtained from Schedule T.
Growth of company (ratios; i.e., changes in premium-to-surplus ratio for future solvency/financial strength).	This information is in the annual statement as well. Any growth issues should be covered under the findings.
Mortality and loss experience (summary of any significant items).	We would not recommend including this item unless something unusual is noted.
Reinsurance (include a description of the company's reinsurance methodology).	We suggest deleting a 'boiler plate' requirement. Any reinsurance issues should be covered in the findings.
Accounts and records (system employed by the company and any related deficiencies, significant delays encountered in obtaining examination-requested information).	We recommend deleting. Only include if there is a specific examination finding.
Statutory deposits (schedule by state, type of asset on deposit and corresponding aggregate deposit, and market values).	We recommend deleting and including any issues in the findings.
Comments on financial statement items (comments concerning non-compliance or material changes to the financial statements, which may include a more in-depth discussion of items covered in "Summary of significant findings").	We don't believe a separate section is needed. Any problems could be covered in the findings.
Summary of recommendations (company improvements in processes, activities and/or controls).	Findings may already have been included earlier in the report. Regardless, findings should only be listed once in the report – it's not necessary to provide a list and then a summary of the list.
Signature page (signatures of Examiner-In-Charge and any other individuals deemed necessary by the state).	Each state seems to have its own preference here and may be driven by statute in some instances. Recommend retaining as necessary.



Part II: Financial Statements

On the last call of the Financial Examination Report (E) Subgroup, it was discussed whether the financial statements should be included in the examination report and what contextual language introducing the financial statements may be necessary. The consensus appeared to be that yes, the financials should be retained as a required element of the examination report. Since we do not have the authority as financial examiners to opine on the accuracy and fair statement of the information presented in the financial statements, it is necessary to clearly represent the context in which the financial statements are represented. With that in mind, please provide suggestions for what may need to be included in the language that introduces the financial statements within the exam report.

Some suggested language to indicate the examiner is not opining on the financial statements could include wording such as:

The examination team used the work of the Designated Independent Public Accountants related to these financial statements. (Note: we recommend the word “used” in this sentence and suggest that the NAIC Handbook avoid the use of words like “reviewed” or “accepted”. States are users of the CPA’s audit report, and accordingly, the CPA firm and the insurer’s management are responsible for the financial statements.)

Other comments that RRC offers:

1. Guidance could be included as to how to address separate accounts in an exam report (particularly the financial statements) as there always seems to be questions associated with this area.
2. Guidance is needed as to a consistent way (e.g., that is agreed to by all states) on how to report upon exam adjustments.
3. As long as the criteria of “findings of fact” remains as the guiding principle for what goes into the examination report, there will be many areas such as best practices, governance observations, etc. that will not be included within the report but instead would be a part of a management letter (to the extent a state is allowed to issue a management letter; some states do not). It would be helpful if the management letter could become a more standardized document and carry more weight. Perhaps more guidance and standardization could be developed for this area as this entire process moves ahead.
4. Comments should be required on prospective solvency risk. Where ORSA is available the examiner will have different views of capital to supplement RBC. Also the stressed scenarios may indicate greater capital needs than RBC, and that should be addressed in the report.
5. Comments should be encouraged on liquidity risk. This risk is addressed in ORSA but not directly by RBC. Addressing both liquidity and capital risks in examination reports would pull together many of the SMI initiatives. It would also provide more insight than simply focusing on RBC.