FINANCIAL EXAMINATIONS IN THE POST-COVID ERA

A CLOSER LOOK AT CHANGES TO FINANCIAL EXAMS AND POTENTIAL SOLUTIONS TO HIGH EXAM FEES

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INTRODUCTION

Financial solvency regulation in the insurance industry has experienced monumental changes since the global financial crisis of the late 2000s. Financial requirements and the subsequent examinations companies undergo every three to five years have been subjected to the most significant changes; many of which have come at the direction of the National Association of Insurance Commissioners.

Through some of the industry's most challenging times, the NAIC has introduced new regulations for insurance companies to comply with and resulted in more work for insurance departments that are often lacking the resources needed to appropriately regulate insurance markets in their state. On top of additional regulations, insurance departments have adopted risk-focused surveillance, which has been incorporated into the examination approach so financial examiners can conduct more efficient financial examinations. These factors are further complicated by the effects of an aging workforce, with the U.S. Bureau of Labor Statistics projecting the insurance industry losing around 400,000 workers through attrition by 2026. With few options for insurance departments to replace those who retire, they are increasingly enlisting the services of third-party vendors in conducting financial examinations and to fill other regulatory needs. This, in part, has led to the continued increase in financial examination costs, increases in some cases of 100 percent or more from one exam to the next. Since COVID-19, financial exams are increasingly virtual experiences. This presents different challenges that companies must be able to handle to successfully manage their financial exams.

As regulators and insurers continue to find their way in this evolving environment, this paper explores the history of financial examinations; the introduction of the risk-focused approached that ushered in the concept of branded risks; cost drivers such as duplication and outsourced regulation; and some potential solutions to curbing ever-increasing exam costs. This paper also shares ideas for how to make an exam a better value proposition for the company being examined.

THE EVOLUTION OF THE FINANCIAL CONDITION EXAMINATION

A SIGNIFICANT COMPONENT OF STATE SOLVENCY REGULATION

In the United States, insurance company solvency regulation consists of five major inputs, the core of which are periodic financial condition examinations and ongoing financial analysis.

The financial condition examination is an in-depth look into a company's financial condition. Conducted every three to five years, insurance examiners assess the current financial condition and prospective solvency of an insurance company by reviewing and evaluating the company's business processes, testing the company's controls, and interviewing key members of the company's management team. While it is increasingly more common for these to be conducted virtually in the post-COVID environment, it is not uncommon for components of a financial conditions examination to be conducted on-site.

Financial analysis, typically performed by dedicated insurance department analysts, is used by insurance departments to continually monitor the financial condition of companies. Critical to supporting a well-functioning financial examination process, financial analysis includes reviewing periodic financial reports and documentation of interactions with a company's management to identify areas of concern with regulatory compliance and signs of insolvency. -Typically performed by dedicated insurance department analysts, periodic financial and documentation of interactions with a company's management are reviewed for regulatory compliance and signs of insolvency.

Regulators rely on the three-to-five-year cycle as a means to better understand the complete profile of an insurer or insurance group. The examiners and analysts involved can identify and evaluate risks that could cause an insurer's surplus to be materially misstated, both currently and prospectively, and develop supervisory plans supporting insurance company solvency within their markets.

Figure 1: Risk-Focused Surveillance Cycle

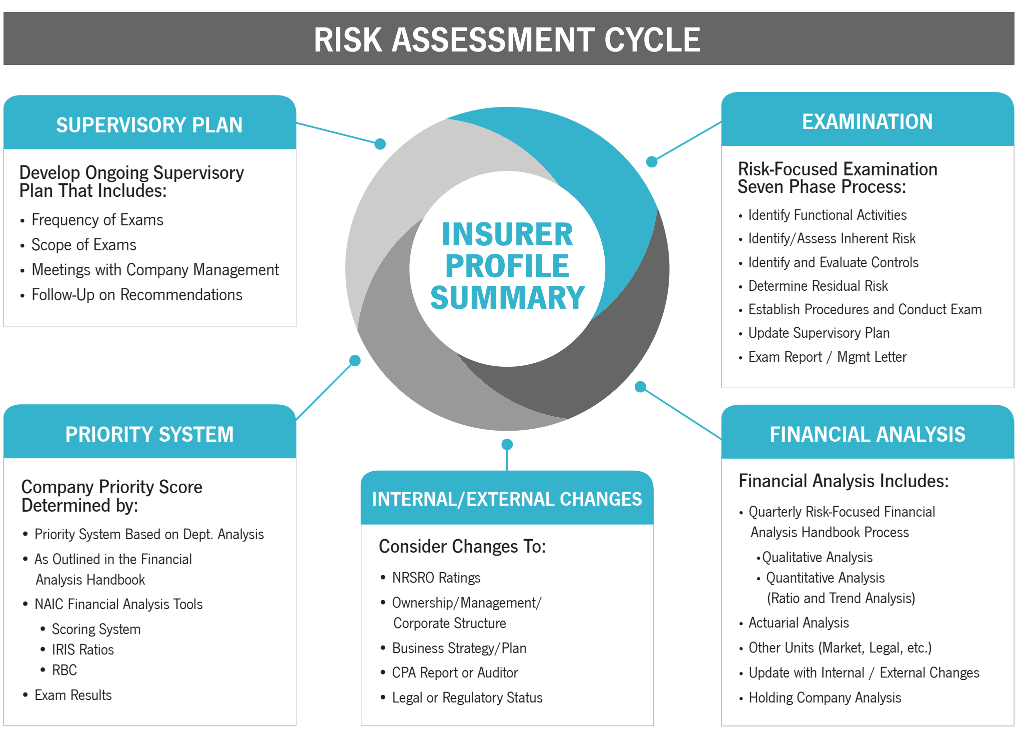


Figure 1: Financial analysis and periodic financial condition examinations represent the core of solvency regulation and two of the five major inputs into the overall U.S. solvency regulation risk assessment cycle.

Risk-focused financial surveillance is a critical task for state insurance departments and a key pillar to the NAIC accreditation program[1]. The current accreditation program requirements for insurance departments contains a model law on examinations[2] that has been adopted in all 50 states. The model requires the insurance commissioner to observe the processes and procedures set forth in the Financial Condition Examiners Handbook,[3] a guide subject to annual changes by various NAIC working groups that are incorporated by reference into respective state law each year. The handbook has undergone revisions since the model was first adopted by the NAIC in 1991, including adopting the risk-focused approach to conducting examinations. This approach was formally adopted by the NAIC in 2010 and incorporated into the Financial Condition Examiners Handbook[4] in 2017. The Handbook is currently adopted in all 50 states.

Risk-focused examinations were welcomed by the industry, as they represented a new approach that would identify and categorize risks into different critical risk categories and tailor the examination to the nature and scale of the company being examined. Historically, the examination process was more quantitative, with checklists to ensure correct amounts were reported. In contrast, the new risk-focused approach is a qualitative approach that takes a more comprehensive view of the current and ongoing operations of the business enterprise. For details about the step-by-step process to the risk-focused examination approach, see Exhibit 1.

Exhibit 1 - A Seven-Step Approach to the Risk-Focused Financial Examination Process

The risk-focused financial examination can be broken down into seven distinct phases. The first two phases can be categorized as planning work that consists of understanding the company and identifying key functional activities to be reviewed and identifying and assessing inherent risk in activities.

In Phase 1, key functional activities that are significant business processes or business units in a company are identified and key subactivities in these units are also identified. The work during this phase continues until the examiner has obtained a level of detail necessary for understanding an activity in a company. In Phase 2, the examiner leverages the work completed by the analysis staff and classifies inherent risks into distinct categories, known as branded risks. From there, the examiner assesses the inherent risks by determining the likelihood of occurrence and magnitude of impact to obtain the overall inherent risk assessment. These early phases are key to understanding how an examiner plans for the examination and how they prioritize and plan to focus on key risks.

The next two phases are the mitigation and control review part of the process. Phase 3 requires the examiner to identify and evaluate controls in place to mitigate inherent risk. Examiners will test internal controls for how well they mitigate identified inherent risks. Under the NAIC's Model Audit Rule, another accreditation standard, it is required that corporate management be responsible for establishing and maintaining an adequate internal control structure and procedures for financial reporting. Therefore, information prepared to comply with these requirements is used to assist the examiner in identifying and assessing risk mitigation strategies and controls.

[1] The NAIC accreditation program relies on state certification by other regulators, requires on-site examinations, and requires solvency-related model laws, rules, and guidelines. Accredited insurance departments are required to undergo an independent review every five years to ensure the department is meeting baseline financial solvency oversight standards. [NAIC Financial Regulation Standards and Accreditation Program – 2023 https://content.naic.org/sites/default/files/inline-files/FRSA%20Pamphlet%201-2023_0.pdf.

[2] NAIC Model Law on Examinations – https://content.naic.org/sites/default/files/MO390.pdf.

[3] NAIC 2023 Financial Condition Examiners Handbook.

[4] Risk-Focused Financial Analysis was adopted into the Financial Analysis Handbook in 2017.

In Phase 4, examiners assess how effectively the controls reduce the level of inherent risk for each risk identified to determine residual risk. Based on the identification of riskier activities, the examiner can determine where to focus examiner or analyst resources and how to test for the risk most effectively.

The next phase of the examination process is the most consequential part of the exam, as it includes substantive testing of the risks identified and requires the examiner to conduct testing based on exam handbook procedures. Examiners prioritize testing based on the level of residual risk, which decreases with the strength of the controls for the risk. The risk-focused nature of the exam comes into play during Phase 5. This is illustrated in that there is not as much substantive testing where the controls are strong or the residual risk is low, but there is increased testing for risks that are backed by weak controls or if residual risk is moderate or high.

The final two phases of the exam include updating the supervisory plan and summarizing the findings. Phase 6 includes an assessment of how the department would prioritize the insurer going forward as it relates to solvency risk. This phase also includes an update to the supervisory plan based on the material findings from the risk assessment exercise. Finally, Phase 7 is when an examination report and management letter are drafted based on the findings. The examination report is required for each full-scope examination and only includes significant findings of fact and general information about the insurer and its financial condition. The management letter is more like examination work papers and includes significant results and observations that are not appropriate or necessary for inclusion in the public examination report but should be communicated to the board and/or management.

While the model law on examinations was adopted quickly in all 50 states, the risk-focused approach to the examination was slow to catch on. As a result, a bifurcation between the new approach and the old approach had emerged, where some states had become very good at the new method while others maintained the old quantitative checklist approach[5]. Much of the divide can be attributed to whether state examiners were regularly attending the NAIC peer-review sessions and obtaining proper training on the risk-focused approach. The NAIC understood that some states[6] do not have adequate resources to send their examiners to its headquarters in Kansas City, Missouri, to attend peer-review sessions. To solve this, the NAIC proposed other ways to address training needs that will be discussed later in this paper.

[5] The NAIC peer-review program is a program whereby states submit exam files to be reviewed and critiqued by other participating state regulators and NAIC staff. The focus of the review and discussion is on reviewing testing performed in Phase 3–5 areas of the risk-focused examination. [NAIC Peer File Review Project –https://content.naic.org/fin_exam_tools_sound_practices.htm .

[6] In 2018 and 2019, the NAIC invested in a project to update the Financial Analysis Handbook to assist state regulators in performing enhanced solvency oversight. The new design allows regulators to quickly identify issues and trends. Also, part of the project included a redesign of the Financial Profile Report, an automated analysis tool. In addition, investments in the NAIC State Ahead Initiative include providing service and support to state insurance departments through the expansion of training for regulators at all levels of state insurance departments. In 2020, the NAIC budget included the final year of the State Ahead Initiative. In 2022, the NAIC began review of a new strategic plan called State Connected.

MUCH HAS CHANGED IN SOLVENCY REGULATION

The risk-focused approach was designed to respond to this regulatory paradigm where the regulators' focus shifted from checking for errors in reporting to corporate governance, enterprise-wide risk management, and critical risks known to cause insolvencies. It came during a time when the NAIC was undergoing a critical self-examination of the U.S. solvency framework, known as the Solvency Modernization Initiative (SMI).[7] Born out of SMI were key financial solvency model laws and regulations that became part of the NAIC accreditation program.[8] These required states to adopt the new laws and regulations, or something substantially similar, to maintain their much-needed accreditation with the NAIC. The risk-focused solvency regulations include the Own Risk and Solvency Assessment Model Act (ORSA), the Corporate Governance Annual Disclosure Model Act and Regulation, changes to the Model Holding Company Act to require an enterprise risk report and to facilitate group supervision, and new capital requirement assessments such as operational risk and catastrophe risk.

One of the key changes to the financial analysis and examination process was the introduction of the concept of branded risk assessment as part of the risk-focused paradigm. This was done to provide examiners a framework to tailor each examination to the key solvency risks of a company. Another benefit to the concept of branded risks was the notion of a common language that could help improve communication between analysts and examiners. The branded risk concept has been incorporated into the U.S. solvency framework in other ways, including as the basis for assessment of Section 2 of the ORSA and in the Summary Review Memorandum as Exhibit AA in Financial Condition Examiners Handbook.[9]

As part of the risk-focused process, financial analysts assess nine branded risk classifications: credit, reserving, legal, market, liquidity, strategic, pricing/underwriting, operational, and reputational. These classifications represent the most common causes of an insurer becoming impaired or insolvent.

Through the course of an examination, examiners provide input and feedback on the branded risk assessments performed. These inputs are summarized and incorporated into the Insurer Profile Summary or Group Profile Summary used to build a profile of the insurer to be used by regulators as a reference point throughout the three-to-five-year solvency cycle.

Moving to a risk-focused approach, developing a common language around branded risks and the new regulations gained from the SMI required regulators and insurers to adapt to significant changes. The regulatory community was rightly focused on the drivers and causes of insolvencies. They recognized that to effectively implement a risk-focused approach they would need to increase training in all the regulations adopted in the states.

[7] NAIC Announces Solvency Modernization Initiative in June 2008 – https://content.naic.org/sites/default/files/legacy/documents/smi_overview.pdf

[8] Through 2012-2015, changes to the Financial Condition Examiners Handbook and Financial Analysis Handbook include the addition of: holding company analysis, supervisory colleges, ORSA reporting and review, Form F reporting and review, Corporate Governance reporting and review, Principle-Based Reserving, Cybersecurity controls, Group Supervision, Insurer Profile Summary and Group Profile Summary. In addition to these changes, the NAIC adopted changes to the Annual Financial Reporting Model Regulation in 2006 (effective 2010) to require reporting on internal controls around financial reporting. As of this writing, Corporate Governance and Group Supervision have not been implemented in all U.S. states, and additional changes to the Model Holding Company Act may be considered as the NAIC implements the new Group Capital Calculation.

[9] Section II of ORSA is the risk-exposure assessment of the ORSA, and insurers assessment includes a pre- and post-mitigation assessment of the nine branded risks. The Summary Review Memorandum (Exhibit AA in Financial Condition Examiners Handbook) is a document used by the financial examiner to communicate information to the financial analyst at the conclusion of an examination.

To aid the analyst and examiner in reviewing and analyzing the information,the NAIC has made several amendments over the years to the Financial Condition Examiners Handbook and the Financial Analysis Handbook. As information and trends emerge, the NAIC continues to revise its handbooks. Most recently in 2023, effective 2024, the NAIC added questions concerning climate to each of the nine branded risk classifications.

For example, now an examiner should ask companies about their investment portfolios and strategies that are exposed to a potential significant impact from transition and asset devaluation risks associated with climate change. Another example of where climate has been specifically added to the financial exam is in the reinsurance questions. For property/casualty companies, examiners are directed to obtain and review information contained in the risk-based capital catastrophe risk charge attestation, the insurer's reconciliation of modeled probable maximum losses to the risk-based capital RCAT filing, evidence of the process used by the insurer to evaluate and approve various reinsurance strategies, and benchmarking information on catastrophic reinsurance coverage and the insurer's coverage with any benchmarking available.[10]

FINANCIAL EXAM FOCUS AREAS

REDUNDANCY IN A RISK-FOCUSED WORLD

Notwithstanding a method that focuses on key solvency risks, many state insurance regulators were overwhelmed by all the new regulations needing to be reviewed, analyzed, prioritized, and possibly tested. The guidance in the handbooks, despite being amended dozens of times, was not clear as to which functionary, analyst, or examiner would perform the work. Adding to the increased workload was a growing frustration among insurance companies that the on-site examination was often full of redundant and duplicative procedures. It was common to hear stories from insurers about examiners doing work that had already been performed by the department analyst in between exam cycles. It became evident that the Financial Condition Examiners Handbook and the Financial Analysis Handbook included considerable overlap that resulted in an inefficient, duplicative examination and analysis process.

By 2016, the chorus of complaints from the industry regarding redundant and duplicative examination experiences could no longer be ignored. Not only was the exam experience frustrating for insurers, the costs associated with examinations were also increasing in dollars spent and in the amount of time and resources dedicated to the process. It was clear that the risk-focused process was not leading to reduced time and money spent on the exam, something it was designed to address. It was then that the NAIC agreed to work with the industry on a solution to address duplicative and redundant handbook guidance. As part of the work performed to overhaul the analysis and examination function, industry stakeholders proposed dozens of changes to each of the handbooks, including that the Financial Analysis Handbook adopt a risk-focused approach. These changes also called for taking a closer look at how information was gathered and how it was processed by each function as well as reviewing the handbooks to eliminate any overlap. Much of the duplication was related to the examiner asking for information already in the possession of the department analyst and reprocessing or retesting it without consulting the analyst or reviewing their assessment. It became evident that in certain cases the examiners were not leveraging the work completed by the department analyst or that the work of the analyst did not necessarily provide enough benefit for examiners.

[10] Climate Risk Enhancements were adopted into the Financial Examiners' Handbook at the Fall 2023 Meeting and will be available in the 2024 version of the Handbook.

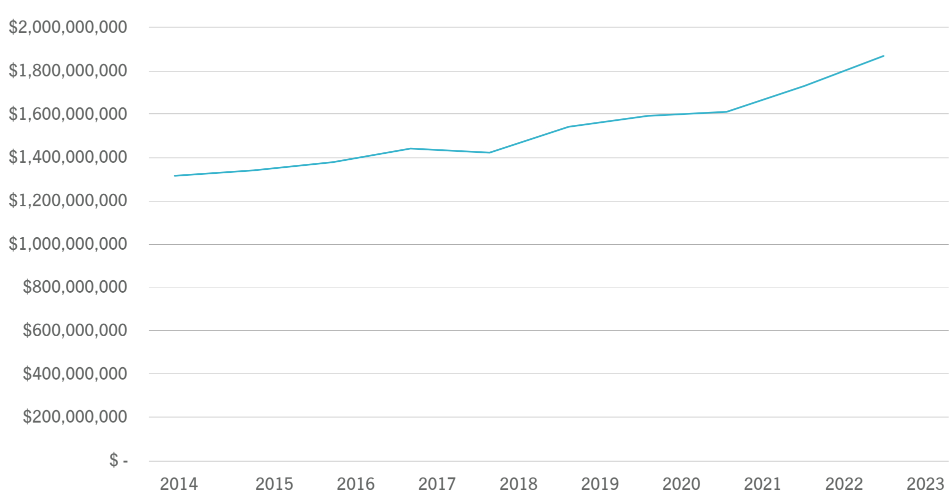
Many of the industry-proposed changes to address the overlap between the two handbooks were accepted by the NAIC. However, a breakdown in communication between analyst and examiner still existed, however, and because of the long cycle time between examinations, certain changes would need time to be incorporated and implemented before any real impact could be realized. If nothing improved over time, the poor communication between functions was going to continue to contribute to higher exam costs and a frustrating experience for insurers. The risk-focused approach to surveillance was intended to usher in a more efficient and tailored approach to financial analysis and examination; yet, in many cases it was having the opposite effect. In addition to the continued problems with communication, other issues were starting to emerge as they related to regulators' ability to manage all the new solvency regulations being adopted by the NAIC and the states.

THE IMPACT OF THIRD-PARTY EXAMINERS

Because of a reduction in staff, initially caused by significant budget cuts in the years following the 2008 financial crisis, insurance departments have increasingly turned to third-party vendors to fill staffing needs. Prior to this time, insurance departments used third-party vendors as specialists to supplement existing staff where unique experience was required - reserving actuaries to perform reserve analysis, for example. Even with insurance department budgets returning to pre-2008 levels, the use of third-party vendors has only increased.

This is particularly true for financial examinations. According to the NAIC Insurance Department Resource Report, there were 602 financial examiners on staff across all 50 states with New York being the highest at 98, and six states (Indiana, Kentucky, New Mexico, Oklahoma, South Dakota, and West Virginia) with no examiners on staff. In the most recent release from the NAIC reporting on staff levels for 2022, New York had reduced the number of examiners to 78 and four additional states (Alaska, Delaware, Georgia, and Mississippi) joined those with no examiners on staff. Fueled by an aging workforce and the Great Resignation in 2021 and further compounded by inefficient processes, it isn't uncommon for entire examinations to be outsourced to third-party vendors, producing a new set of problems.

Figure 3: Aggregate State Insurance Department Budgets [2018 – 2023][11]



[11] NAIC Insurance Department Resources Reports, 2018-2023

Given the already present issues with the lack of communication between department analyst and financial examiner, the problem is exacerbated in states where outside vendors perform on-site financial examinations. Often, third-party examiners are in a different state than the department with which they are contracted, which contributes to a breakdown in communication between contractor and insurance department, not to mention an increase in travel and lodging expenses that are ultimately billed to the company being examined.

Adding to the problems around communication is a lack of oversight of the vendors insurance departments hire to perform on-site examinations. Because the contractor typically works directly with the insurer on budgeting and billing for the time and work performed, the insurance department may not have a sense of the overall costs of financial examinations in its state. This dynamic produces an environment where the insurance department is one step removed from a critical function of state regulators. State insurance commissioners need to increase their oversight capabilities because there is no current incentive for third-party vendors to be efficient with their time, nor is there good reason for them to rely on the work performed by the department analyst. Without proper oversight of these vendors, the issue of ever-increasing exam costs will be difficult to resolve.

NEW AREAS TO CONSIDER

As the financial exam environment changes, there are several new areas to consider in future exams. The first is climate. As discussed previously, climate has made its way into the nine branded risk classifications of the financial condition examination. Companies, particularly property/casualty companies, should be prepared to answer questions regarding their governance strategies around climate change and weather-related risks. Second is the management of a completely virtual financial examination. Since COVID-19, exams have been increasingly conducted in a virtual environment. While the tenants of managing an exam remain the same, insurers will have to adapt to this virtual world and the challenges that come with it. A primary challenge for insurers will be their ability to balance the needs of the exam and provide off-site examiners the appropriate levels of access necessary to perform an examination. Additionally, due to the increased likelihood of miscommunications in a virtual environment during a process already riddled with communication failures, insurers would be wise to engage in the financial condition examination process with more scrutiny than previously required.

A WAY FORWARD – SOLUTIONS ON THE HORIZON

The risk-focused approach to financial analysis and examination, the numerous new laws and regulations insurers need to comply with, the trend of outsourcing the financial examination function, and the existing breakdown in communication between analyst and examiner, all combine to create many obstacles in insurers' paths to tackle the problem of ever-increasing financial examination costs. But there are potential solutions on the horizon and a hope that the risk-focused process can be better incorporated into state methods and communication can be improved.

While the challenges associated with state insurance department resources may not be quickly or easily overcome, department oversight of outside examiners can be enhanced. In 2018, Pennsylvania passed Act 41, which amended the Insurance Department Act of 1921 requiring the state insurance department to produce an annual examination and analysis report detailing the total amount of money billed to companies by the department and its contractors for purposes of the financial examination.[12] In addition, the act requires scheduling conferences between the department and the company being examined to establish a budget and discuss which vendors will be used for the examination. This presents a great opportunity to improve vendor oversight and will provide useful information for the public to better understand how much regulation is being outsourced and why. In addition, there is an opportunity for the company being examined to be more involved in the budget process from the outset of the exam.

Other insurance departments could benefit from a similar law, as it would bring to light the costs of outsourcing financial examinations in their states. It could also signal to state governments just how dependent insurance departments have become on third-party regulation. Whether that leads to insurance departments having a better reason to retain more of the funds they already raise through premium taxes or other methods is a question to be considered. The dynamic of having to outsource this function may not go away, so it will be important for insurance departments to maintain some degree of oversight and control of the process.

In addition to potential state law changes, the recent amendments to the NAIC handbooks have not been fully appreciated for how they could improve communication between analyst and examiner. One change that regulators and the industry should be aware of is related to Exhibit D in the exam handbook.

[12] PA 2018 Act 41 – Insurance Department Act of 1921 - Omnibus Amendments – https://www.legis.state.pa.us/cfdocs/legis/li/uconsCheck.cfm?yr=2018&sessInd=0&act=41.

This is a required planning meeting between the financial analyst and the financial examiner at the outset of the examination with the purpose of gaining an understanding of the company operations and risks and identifying work already performed by the analyst along with the documents that have already been obtained. This change alone will go a long way to alleviating many of the headaches companies have been experiencing around redundant processes. Companies about to undergo an exam need to ask whether this meeting has occurred, regardless of whether an outside examiner is being used.

Finally, ensuring that state regulators are receiving adequate training is directly related to the number of resources available at each insurance department. Many states that are well versed with the risk-focused approach regularly attend NAIC peer-review sessions and complete NAIC training courses. Those states tend to have more resources available to them. The NAIC knows it has a responsibility to provide as much support as it can to the states; therefore, it has increased the amount of training opportunities through the development of webinars and other online training resources.

Its most recent strategic plan, State Connected (2023-2025), builds on investments in talent, technology, and resources made during its previous State Ahead plan.[13] To accomplish this, the NAIC has identified key initiatives around expanding in-house expertise and modernizing the education and training resources they provide regulators. They are investing heavily in updating the technologies used by insurers and regulators during examinations and other regulatory activities with multiple years-long projects to bring antiquated systems such as Financial Data Repository, Regulatory Information Retrieval System, State Based Systems, and Online Premium Tax for Insurance up to date.

MAKE YOUR NEXT EXAMINATION A MORE VALUABLE PROPOSITION

There are many actions companies can take and information they should be aware of that can contribute to a more valuable financial exam experience. These include effective and timely communication, more involvement in the budget process, providing available information to exam teams, and proposing ways to save time. These activities are important in controlling the overall cost of the examination. There are other opportunities to add to the value proposition of future examinations through the development of a strategy that identifies trends that the regulatory community is following. Today, those trends include having a good grasp of a company's critical risks, corporate governance and enterprise risk management strategy, third-party/vendor management, and cybersecurity policy.

COMMUNICATION, COMMUNICATION, COMMUNICATION

As in all good relationships, communication is key. This paper has already explored some of the communication breakdowns, including between financial analysts and financial examiners, and has also provided a discussion on potential solutions to those problems, but the company being examined can take some responsibility in improving communication as well. Nobody knows a company better than its management, and anything management can do to help the examiner will only benefit the overall product that is produced. In the case of financial examinations, the product is the examination report and the management letter. Having an open line of communication with the exam team, from the initial exam kickoff meeting through to the production of the exam report, is very beneficial. Knowing that the exam team is open to discussing the most efficient way of completing exam tasks and understanding what is being tested and why is helpful to both examiner and examinee. Plus, having effective communication with the exam team can help reduce overall exam fees.

[13] NAIC State Ahead Plan- https://content.naic.org/state_ahead.htm#:~:text=State%20Ahead%20is%20a%20three,insurance%20departments%20to%20draw%20upon.

REGULARLY DISCUSS THE BUDGET

Another way to keep a close eye on exam fees is for companies to meet with the exam team early on to discuss the budget. Companies should understand how the department came up with its estimates and see if there are opportunities for cost savings. Much of the budget may include travel and lodging fees, particularly if a third-party vendor is used. Companies should see if any work can be done at the department or the vendor's home office – in an ever-increasing virtual world much of the work does not need to occur on-site. In cases where third-party vendors are used, companies should understand where they are traveling from and what their rates will be. If it is an out-of-state vendor, they should ask why the department is using out-of-state vendors and if there are local options.

In addition to meeting early in the exam process, companies should set up periodic meetings to discuss how the work is proceeding and to track the budget. They should understand that the exam handbook guidance requires a meeting between examiner and examinee when it is likely that total fees will exceed the budget by more than 10 percent. Furthermore, if the exam is being conducted by third-party vendors, companies should check in with the state insurance department to ensure it is monitoring the amount of time being spent on the exam and how that corresponds with budget estimates.

PROVIDE AVAILABLE INFORMATION

Understanding the scope of the exam is critical to knowing what information a company should provide. Having those early conversations as the exam team is doing the planning work offers the opportunity to learn what will be in scope and what may be tested and gather information that will aid the exam team. Internal audit reports, CPA review documents and workpapers, board of directors meeting agendas and memos, and any other pertinent information are always welcomed. Anything that helps move along the process of the examination can reduce the amount of time needed to perform any given task and, in turn, lower exam fees.

PROPOSE IDEAS TO PROMOTE EFFICIENCY

Management is in the best position to talk about the company and the risks it faces and should be involved in the discussions with the exam team about what risks will be tested and how. Management has the benefit of knowing what was tested during the previous examination and if any inefficiencies could be overcome this time. The exam team should be open to discussing ideas with the company about more efficient ways to approach any given testing process. To reduce exam fees, it may benefit the company to get involved in the minutia of the exam procedures and demonstrate a way to reduce the number of hours it may take to conduct a test or procedure.

CRITICAL RISKS

Companies should be aware that state financial examiners will be focused on critical risks throughout the exam process. In preparation for this, companies should have critical risks mitigation strategies mapped out and ready to share with examiners. Exam teams will be able to leverage the work performed by the company and review the risks identified, leading to efficiencies and potentially reduced costs. Mapping out these strategies is a good exercise for executives to help them prepare for interviews conducted by the exam team.

CORPORATE GOVERNANCE AND ENTERPRISE RISK MANAGEMENT STRATEGY

Insurers are already expected to provide regulators detailed information regarding their corporate governance structures and enterprise risk management practices because of the Corporate Governance Annual Disclosure Model Act and Regulation and the Own Risk and Solvency Assessment. In regard to the examination, the exam team will conduct interviews with senior management to assess certain qualities of the company's corporate governance and enterprise risk management strategy. Exam teams want to know more about the company's board size and structure as well as senior management policies and practices. In addition to the filings under CGAD and ORSA, examiners are interested in assessing how well informed the company board is on critical risk areas. Exam teams expect formal documentation of risks and risk mitigation strategies and are interested in learning about a company's ERM processes and what support exists for current risk mitigation strategies.

THIRD-PARTY/VENDOR MANAGEMENT

A component of the financial examination that has been at the forefront of regulators' minds in recent years is the information technology portion of the exam, and within that component resides the role of identifying and assessing risks associated with doing business with third-party vendors. Exam teams are interested in learning more about how companies manage and monitor their relationships with these vendors. Expected as part of the IT examination is a review of the service providers, including those that affect financial reporting, because those organizations are required to comply with certain standards reports around internal controls.[14] As part of this review, examiners are checking to see if the third-party vendor reports are reviewed and if user-control considerations are addressed and documented.

INFORMATION TECHNOLOGY REVIEW

Also included as part of the information technology examination is an assessment of the company's exposure to cybersecurity risks. The exam team is interested in learning more about the types of sensitive information maintained or accessed by the company. The examination of IT used by an insurer has become an increasingly important part of the examination process as companies have placed a greater reliance on IT systems to run their businesses. IT general controls are policies and procedures that help ensure proper operation of computer systems, including controls over network operations, software acquisition and maintenance, and access security. Insurers can expect to fill out the Information Technology Planning Questionnaire included in Exhibit C- Part One.

Some general considerations the exam team will review are complexity of the insurer's information systems and IT risk mitigation strategies, the types of subsystems being used and how information is shared among systems, and any past issues the insurer may have had. The team is also interested in what and how much information can be accessed by outside vendors. Among the key interviews is with a member of the IT senior management team during which examiners will ask about the interaction between the board of directors, the internal IT team and the board's understanding of the IT control framework. Companies should identify early on who the point of contact is for IT questions, preferably someone who has in-depth knowledge of the IT system.

[14] Statement on Standards for Attestation Engagements (SSAE) No. 18 includes a Service Organization Controls (SOC 1) report that is a report on controls at a service organization that may be relevant to user entities' internal control over financial reporting.

If an exam is virtual, companies should consider screen sharing with the examiners and maintaining control of the screen, or at least remaining in the room while the exam is being conducted. The examiner is entitled to test controls in the IT environment, but this work should be completed with the assistance of the IT staff and should use the existing work of others, if appropriate.

Other areas of interest include how well-trained employees are in the company's cybersecurity policy and whether network activity is adequately monitored. From the IT examiner's perspective, IT systems are considered generally effective when they maintain the integrity of information and the security of the data and include effective general IT and application controls

CONCLUSION

While the 2008 financial crisis was a catalyst for significant changes in financial solvency regulation, its evolution has been heavily impacted by the challenges of adjusting to a post-COVID world. The historic amount of requirements as well as the dwindling number of staff examiners are strongly influencing the trend of outsourcing insurance regulation. With the routine addition of new requirements and disclosures by the NAIC and states, financial solvency regulations may be one of the most complicated aspects of the insurance industry. While it may appear to be an uphill battle to address all factors contributing to the rise in exam fees, insurers can make their next exam a more valuable experience by using clear, consistent and transparent communication throughout the process. In addition, active involvement in third-party vendor oversight may contribute to a halt on ever-increasing exam fees.

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