

NAIC POLICY STATEMENT ON FINANCIAL REGULATION STANDARDS

Part A: Laws and Regulations – Traditional Insurers

Preamble

The purpose of the Part A: Laws and Regulations Standards is to assure that an accredited state has sufficient authority to regulate the solvency of its multi-state domestic insurance industry in an effective manner. The Part A standards are the product of laws and regulations that are believed to be basic building blocks for sound insurance regulation. A state may demonstrate compliance with a Part A standard through a law, a regulation, an established practice, which implements the general authority granted to the state or any combination of laws, regulations or practices, which achieves the objective of the standard.

The following Part A standards apply to traditional forms of “multi-state domestic insurers.” This scope includes life/health and property/casualty/liability insurers and reinsurers that are domiciled in the accredited state and licensed, accredited or operating in at least one other state. This scope also includes insurers that are domiciled in the accredited state and operating or accepting business on an exported basis in at least one other state as excess and surplus lines insurers or as risk retention groups; except that the term does not include risk retention groups (RRGs) incorporated as captive insurers. Part A standards for RRGs are included in the following section. It also does not include those insurers that are licensed, accredited or operating in only their state of domicile but are assuming business from insurers writing that business that is directly written in a different state. The terms “insurer” and “insurers” used in the Part A standards fall within the definition of “multi-state domestic insurers.” For the purpose of this definition, the term “state” is intended to include any NAIC member jurisdiction, including U.S. territories.

1. Examination Authority

The department should have authority to examine companies whenever it is deemed necessary. Such authority should include complete access to the company’s books and records and, if necessary, the records of any affiliated company, agent, and/or managing general agent. Such authority should extend not only to inspect books and records but also to examine officers, employees and agents of the company under oath when deemed necessary with respect to transactions directly or indirectly related to the company under examination. The NAIC Model Law on Examinations or substantially similar provisions shall be part of state law.

2. Capital and Surplus Requirement

The department should have the ability to require that insurers have and maintain a minimum level of capital and surplus to transact business. The department should have the authority to require additional capital and surplus based upon the type, volume and nature of insurance business transacted. The Risk-Based Capital (RBC) for Insurers Model Act or provisions substantially similar shall be included in state laws or regulations.

3. NAIC Accounting Practices and Procedures

The department should require that all companies reporting to the department file the appropriate NAIC annual statement blank, which should be prepared in accordance with the NAIC’s instructions handbook

and follow those accounting procedures and practices prescribed by the NAIC *Accounting Practices and Procedures Manual*, utilizing the version effective January 1, 2001 and all subsequent revisions adopted by the Financial Regulation Standards and Accreditation (F) Committee (FRSAC).

4. Corrective Action

State law should contain the NAIC's Model Regulation to Define Standards and Commissioner's Authority for Companies Deemed to be in Hazardous Financial Condition or a substantially similar provision, which authorizes the department to order a company to take necessary corrective action or cease and desist certain practices that, if not corrected, could place the company in a hazardous financial condition.

5. Valuation of Investments

The department should require that securities owned by insurance companies be valued in accordance with those standards promulgated by the NAIC's Capital Markets and Investment Analysis Office. Other invested assets should be required to be valued in accordance with the procedures promulgated by the NAIC's Financial Condition (E) Committee.

6. Holding Company Systems

State law should contain the NAIC Model Insurance Holding Company System Regulatory Act or an Act substantially similar, and the department should have adopted the NAIC's model regulation relating to this law.

7. Risk Limitation

State law should prescribe the maximum net amount of risk to be retained by a property and liability company for an individual risk based upon the company's capital and surplus. This limitation should be no larger than 10% of the company's capital and surplus.

8. Investment Regulations

State statute should require a diversified investment portfolio for all domestic insurers both as to type and issue and include a requirement for liquidity. Foreign companies should be required to substantially comply with these provisions.

9. Liabilities and Reserves

State statute should prescribe minimum standards for the establishment of liabilities and reserves resulting from insurance contracts issued by an insurer; including life reserves, active life reserves and unearned premium reserves, and liabilities for claims and losses unpaid and incurred but not reported claims. The NAIC's Standard Valuation Law, Actuarial Opinion and Memorandum Regulation and Property and Casualty Actuarial Opinion Model Law or substantially similar provisions shall be in place.

10. Reinsurance Ceded

State law should contain the NAIC Model Law on Credit for Reinsurance, the NAIC's Credit for Reinsurance Model Regulation and the NAIC Life and Health Reinsurance Agreement Model Regulation or substantially similar laws.

11. CPA Audits

State statute or regulation should contain a requirement for annual audits of domestic insurance companies by independent certified public accountants, based on the NAIC's Annual Financial Reporting Model Regulation.

12. Actuarial Opinion

State statute or regulation should contain a requirement for an opinion on reserves and loss and loss adjustment expense reserves by a qualified actuary or specialist on an annual basis for all domestic insurance companies.

13. Receivership

State law should set forth a receivership scheme for the administration, by the insurance commissioner, of insurance companies found to be insolvent similar to that set forth in the NAIC's Insurer Receivership Model Act.

14. Guaranty Funds

State law should provide for a regulatory framework such as that contained in the NAIC's model acts on the subject, to ensure the payment of policyholders' obligations subject to appropriate restrictions and limitations when a company is deemed insolvent.

15. Filings with NAIC

State statute, regulation or practice should mandate filing of annual and quarterly statements with the NAIC in a format acceptable to the NAIC except that states may exempt from this requirement those companies that operate only in their state of domicile.

16. Producer Controlled Insurers

States should provide evidence of a regulatory framework, such as that contained in the NAIC's model law for Business Transacted with Producer Controlled Property/Casualty Insurer Act or similar provisions.

17. Managing General Agents Act

States should provide evidence of a regulatory framework, such as that contained in the NAIC's Managing General Agents Model Act or similar provisions.

18. Reinsurance Intermediaries Act

States should provide evidence of a regulatory framework, such as that contained in the NAIC's Reinsurance Intermediary Model Act or similar provisions.

19. Regulatory Authority

State law should provide for a regulatory framework for the organization, licensing and change of control of domestic insurers.

Note: If a state can provide evidence that none of the entities contemplated in above standards 14, 16, 17 or 18, is either present or allowed to operate in the state, it will not need to demonstrate compliance with that standard.

Part A: Laws and Regulations – Risk Retention Groups

The following Part A standards apply to RRGs incorporated as captive insurers. This scope includes RRGs that are chartered in the accredited state and registered or operating in at least one other state. For the purpose of this definition, the term “state” is intended to include any NAIC member jurisdiction, including U.S. territories.

1. Examination Authority

The department should have authority to examine RRGs organized as captive insurers whenever it is deemed necessary. Such authority should include complete access to the RRG’s books and records and, if necessary, the records of any affiliated company, agent, and/or managing general agent. Such authority should extend not only to inspect books and records but also to examine officers, employees, and agents of the RRG under oath when deemed necessary with respect to transactions directly or indirectly related to the RRG under examination. The NAIC Model Law on Examinations or substantially similar provisions shall be part of state law.

2. Capital and Surplus Requirement

The department should have the ability to require that RRGs have and maintain a minimum level of capital and surplus to transact business. The department should have the authority to require additional capital and surplus based upon the type, volume, and nature of insurance business transacted.

3. NAIC Accounting Practices and Procedures

The department should require that RRGs reporting to the department file the appropriate NAIC Annual Statement Blank which should be prepared in accordance with the NAIC’s Instructions Handbook, as applicable. The RRGs should follow those accounting procedures and practices prescribed by the NAIC *Accounting Practices and Procedures Manual* or another basis of accounting as permitted or prescribed by state law or regulation.

4. Corrective Action

State law should contain the NAIC’s Model Regulation to Define Standards and Commissioner’s Authority for Companies Deemed to be in a Hazardous Financial Condition or a substantially similar provision which authorizes the department to order a RRG to take necessary corrective action or cease and desist certain practices which, if not corrected, could place the RRG in a hazardous financial condition.

5. Valuation of Investments

The department should require that securities owned by RRGs be valued in accordance with those standards promulgated by the NAIC’s Capital Markets and Investment Analysis Office or, if a basis of accounting other than SAP is used, the state must have authority to determine the valuation of securities. For RRGs that use SAP, other invested assets should be required to be valued in accordance with the procedures promulgated by the NAIC’s Financial Condition (E) Committee. For RRGs that use another basis of accounting, the state must have authority to determine valuation of securities.

6. Holding Company Systems

State law should contain the NAIC Model Holding Company Systems Act or an act substantially similar and the department should have adopted the NAIC’s model regulation relating to this law.

7. Risk Limitation

State law should provide the state insurance department with clear authority in statute or regulation to limit the net amount of risk retained for an individual risk.

8. Investment Regulations

State statute should require a diversified investment portfolio for RRGs both as to type and issue and include a requirement for liquidity.

9. Liabilities and Reserves

State statute should prescribe minimum standards for the establishment of liabilities and reserves resulting from insurance contracts issued by an RRG; including unearned premium reserves and liabilities for claims and losses unpaid and incurred but not reported claims.

10. Reinsurance Ceded

State law should contain the NAIC Model Law on Credit for Reinsurance, the NAIC's Credit for Reinsurance Model Regulation or substantially similar laws.

11. CPA Audits

State statute or regulation should contain a requirement for annual audits of domestic RRGs by independent certified public accountants, based on the NAIC's Annual Financial Reporting Model Regulation.

12. Actuarial Opinion

State statute or regulation should contain a requirement for an opinion on loss and loss adjustment expense reserves by a qualified actuary or specialist annually for all domestic RRGs.

13. Receivership

State law should set forth a receivership scheme for the administration, by the insurance commissioner, of RRGs found to be insolvent similar to the NAIC's Insurer Receivership Model Act.

14. Filings with NAIC

State statute, regulation or practice should mandate filing of annual and quarterly statements with the NAIC in a format acceptable to the NAIC except that states may exempt from this requirement those RRGs that operate only in their state of domicile.

15. Producer Controlled Insurers

States should provide evidence of a regulatory framework, such as that contained in the NAIC's Model Law for Business Transacted with Producer Controlled Property/Casualty Insurer Act or similar provisions.

16. Managing General Agents Act

States should provide evidence of a regulatory framework, such as that contained in the NAIC's Managing General Agents Act or similar provisions.

17. Reinsurance Intermediaries Act

States should provide evidence of a regulatory framework, such as that contained in the NAIC's Reinsurance Intermediary Model Act or similar provisions.

Note: If a state can provide evidence that none of the entities contemplated in above standards 15, 16, or 17, is either present or allowed to operate in the state (in relation to RRGs), it will not need to demonstrate compliance with that standard.

Part B: Regulatory Practices and Procedures

Preamble

The purpose of Part B is to identify base-line regulatory practices and procedures required to supplement and support enforcement of the states' financial solvency laws in order for the states to attain substantial compliance with the core standards established in Part A. Part B identifies standards that are to be applied in the regulation of all forms of multi-state insurers.

Part B sets out standards required to ensure adequate solvency regulation of multi-state insurers. Each state must make an appropriate allocation of its available resources to effectively address its regulatory priorities. In addition to a domestic state's examination and analysis activities, other checks and balances exist in the regulatory environment. These include other states' regulation of licensed foreign companies, the appropriate application of FAST and IRIS ratios, the analyses by NAIC's staff, the NAIC Financial Analysis Working Group, the NAIC Analyst Team Project, and to some extent the evaluation by private rating agencies.

The scope of Part B is broader than the scope of Part A. "Multi-state insurer" as used in Part B encompasses all forms of insurers domiciled or chartered in the accredited state and licensed, registered, accredited or operating in at least one other state. This scope also includes insurers that are domiciled in the accredited state and operating or accepting business on an exported basis in at least one other state as excess and surplus lines insurers. It does not include those insurers that are licensed, accredited or operating in only their state of domicile but are assuming business from insurers writing that business that is directly written in a different state. The term "insurer" in Part B includes traditional insurance companies as well as, for instance, health maintenance organizations and health service plans, captive risk retention groups, and other entities organized under other statutory schemes. Although this scope includes risk retention groups organized as a captive insurer, it does not include any other type of captive insurer. While the unique organizational characteristics of some of these entities may require specialized laws, their multi-state activity demands solvency oversight that employs the base-line regulatory practices and procedures identified in Part B. For purposes of this definition, the term "state" is intended to include any NAIC member jurisdiction, including U.S. territories.

The accreditation program recognizes that complete standardization of practices and procedures across all states may not be practical or desirable because of the unique situations each state faces. States differ with respect to staff and technology resources that are available as well as the characteristics of the domestic industry regulated. For example, states may choose to emphasize automated analysis over manual or vice versa. Reliable results may be obtained using alternative, yet effective, financial solvency oversight methodologies. The accreditation program should not emphasize form over substance in its evaluation of the states' solvency regulation.

1. Financial Analysis

(a) Sufficient Qualified Staff and Resources

The department should have the resources to review effectively on a periodic basis the financial condition of all domestic insurers.

(b) Communication of Relevant Information to/from Financial Analysis Staff

The department should provide relevant information and data received by the department, which may assist in the financial analysis process to the financial analysis staff and ensure that findings of the financial analysis staff are communicated to the appropriate person(s).

(c) Appropriate Supervisory Review

The department's internal financial analysis process should provide for appropriate supervisory review and comment.

(d) Priority-Based Analysis

The department's financial analysis procedures should be priority-based to ensure that potential problem companies are reviewed promptly. Such a prioritization scheme should utilize appropriate factors as guidelines to assist in the consistent determination of priority designations.

(e) Appropriate Depth of Review

The department's financial analysis procedures should ensure that domestic insurers receive an appropriate level or depth of review commensurate with their financial strength and position.

(f) Documented Analysis Procedures

The department should have documented financial analysis procedures and/or guidelines to provide for consistency and continuity in the process and to ensure that appropriate analysis procedures are being performed on each domestic insurer.

(g) Reporting of Material Adverse Findings

The department's procedures should require that all material adverse indications be promptly presented to the commissioner or an appropriate designee for determination and implementation of appropriate regulatory action.

(h) Action on Material Adverse Findings

Upon the reporting of any material adverse findings from the financial analysis staff, the department should take timely action in response to such findings or adequately demonstrate the determination that no action was required.

2. Financial Examinations

(a) Sufficient Qualified Staff and Resources

The department should have the resources to effectively examine all domestic insurers on a periodic basis in a manner commensurate with the financial strength and position of each insurer.

(b) Communication of Relevant Information to/from Examination Staff

The department should provide relevant information and data received by the department, which may assist in the examination process to the examination staff and ensure that findings of the examination staff are communicated to the appropriate person(s).

(c) Use of Specialists

The department's examination staff should include specialists with appropriate training and/or experience or otherwise have available qualified specialists, which will permit the department to effectively examine any insurer. These specialists should be utilized where appropriate given the complexity of the examination or identified financial concerns.

(d) Appropriate Supervisory Review

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.

(e) Use of Appropriate Guidelines and Procedures

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.

(f) Performance and Documentation of Risk-Focused Examinations

The department's performance and documentation of risk-focused examinations should generally follow the guidance set forth in the NAIC *Financial Condition Examiners Handbook*. Appropriate variations in method and scope should be commensurate with the financial strength and position of the insurer.

(g) Scheduling of Examinations

In scheduling financial examinations, the department should follow procedures such as those set forth in the NAIC *Financial Condition Examiners Handbook* that provide for the periodic examination of all domestic companies on a timely basis. This system should accord priority to companies that exhibit adverse financial trends or otherwise demonstrate a need for examination.

(h) Examination Reports

The department's reports of examination should be prepared in accordance with the format adopted by the NAIC and should be sent to other states in which the insurer transacts business in a timely fashion.

(i) Reporting of Material Adverse Findings

The department's procedures should require that all material adverse findings be promptly presented to the commissioner or an appropriate designee for determination and implementation of appropriate regulatory action.

(j) Action on Material Adverse Findings

Upon the reporting of any material adverse findings from the examination staff, the department should take timely action in response to such findings or adequately demonstrate the determination that no action was required.

3. Information Sharing and Procedures for Troubled Companies

(a) Information Sharing

States should allow for the sharing of otherwise confidential documents, materials, information, administrative or judicial orders, or other actions with the regulatory officials of any state, federal agency or foreign countries providing that the recipients are required, under their law, to maintain its

confidentiality. States also should allow for the sharing of otherwise confidential documents, materials, information, administrative or judicial orders, or other actions with the NAIC providing that the NAIC demonstrates by written statement the intent to maintain its confidentiality. The department should have a documented policy to cooperate and share information with respect to domestic companies with the regulatory officials of any state, federal agency or foreign countries and the NAIC directly and also indirectly through committees established by the NAIC, which may be reviewing and coordinating regulatory oversight and activities. This policy should also include cooperation and sharing information with respect to domestic companies subject to delinquency proceedings.

(b) Procedures for Troubled Companies

The department should generally follow and observe procedures set forth in the NAIC *Troubled Insurance Company Handbook*. Appropriate variations in application of procedures and regulatory requirements should be commensurate with the identified financial concerns and operational problems of the insurer.

Part C: Organizational and Personnel Practices

1. Professional Development

The department should have a policy that encourages the professional development of staff involved with financial surveillance and regulation through job-related college courses, professional programs, and/or other training programs.

2. Minimum Educational and Experience Requirements

The department should establish minimum educational and experience requirements for all professional employees and contractual staff positions in the financial regulation and surveillance area, which are commensurate with the duties and responsibilities of the position.

3. Retention of Personnel

The department should have the ability to attract and retain qualified personnel for those positions involved with financial surveillance and regulation.

Part D: Organization, Licensing and Change of Control of Domestic Insurers

Preamble

The focus of the Part D standards is on strengthening financial regulation and the prevention of unlicensed or fraudulent activities. The scope of this section only includes the licensing of new companies and Form A filings. The section applies to only traditional life/health and property/casualty companies, and this scope is narrower than that of Part B in that it does not include entities such as health maintenance organizations, health service plans, and captive insurers (including captive risk retention groups). These standards only deal with the department's analysis of domestic companies and do not include foreign or alien insurers. The initial company licensing process does not consider the "multi-state" concept since the company is in its initial licensing phase. The standards regarding Form A filings deal with only filings submitted related to multi-state insurers, as that term is defined in the Part B Preamble.

1. Qualified Staff and Resources

The department should have minimum educational and experience requirements for licensing staff commensurate with the duties and responsibilities for analyzing company applications. Staff responsible for analyzing applications should have an accounting, insurance, financial analysis or actuarial background.

2. Sufficient Staff and Resources

The department should have sufficient resources to effectively review applications for primary licensure or Form A filings in a timely manner.

3. Scope of Procedures for Primary Applications

The department should have documented licensing procedures that include a review and/or analysis of key pieces of information included in a primary licensure application.

4. Scope of Procedures for Form A Filings

The department should have documented procedures for the review of key pieces of information included in Form A filings.

5. Use of the Form A Database

The department should utilize the Form A Database as a means of obtaining information on prior filings made by an applicant and informing other states of the receipt and status of Form A filings in a timely manner.

6. Documentation of Work Performed

The department's files should include evidence that the department's procedures were adequately performed and well documented, including a conclusion regarding whether an application or filing is approved or denied.