

NAIC POLICY STATEMENT ON FINANCIAL REGULATION STANDARDS

PART A: LAWS AND REGULATIONS

Preamble for Part A: Laws and Regulations

Purpose of the Part A Standards

The purpose of the Part A: Laws and Regulations standards are 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 considered to be basic building blocks for effective financial solvency regulation. A state may demonstrate compliance with a Part A standard through a law, a regulation, or an administrative practice that implements the general authority granted to the commissioner, or any combination thereof, which achieves the objective of the standard. The term “state” as used herein is intended to include any NAIC member jurisdiction, including U.S. territories. The term “commissioner” means commissioners, directors, superintendents or other officials who by law are charged with the principal responsibility of supervising the business of insurance within each state.

Part A: Laws and Regulations – Excluding Risk Retention Groups Organized as Captives

Scope of the Part A Standards (Excluding Risk Retention Groups Organized as Captives)

Life/Health and Property/Casualty Insurers

The following Part A standards apply to the regulation of a state’s domestic insurers licensed and/or organized under its life/health and property/casualty statutes (life/health or property/casualty insurer), but only if the insurer is a multi-state insurer. NOTE: This section does not apply to a state’s domestic insurers licensed and/or organized under its captive or special purpose vehicle statutes or any other similar statutory construct. For purposes of Part A, a life/health or property/casualty insurer that meets any of the following conditions is considered to be a multi-state insurer and subject to the Part A standards:

- 1) A property/casualty or life/health domestic insurer that is licensed in at least one state other than its state of domicile.
- 2) A property/casualty or life/health domestic insurer that is operating in at least one state other than its state of domicile.
- 3) A property/casualty or life/health domestic insurer that is accredited or certified as a reinsurer in at least one state other than its state of domicile.
- 4) A property/casualty or life/health domestic insurer that is reinsuring business covering risks residing in at least two states.
- 5) A property/casualty domestic insurer that is accepting business on an exported basis as an excess or surplus line insurer in at least one state other than its state of domicile.

Captive Reinsurers

The following Part A standards apply to the regulation of a state’s domestic insurers licensed and/or organized under its captive or special purpose vehicle statutes or any other similar statutory construct (captive insurer) that reinsure business covering risks residing in at least two states, but only with respect to the following lines of business:

- 1) Policies that are required to be valued under Sections 6 or 7 of the *Valuation of Life Insurance Policies Model Regulation* (Model #830) (commonly referred to as XXX/AXXX policies). The application of this provision is intended to have a prospective-only effect, so that regulation of captive insurers, special purpose vehicles and any other entities that reinsure these types of policies will not be subject to the Part A standards if the policies assumed were both (1) issued prior to Jan. 1, 2015, and (2) ceded so that they were part of a reinsurance arrangement as of Dec. 31, 2014. [Drafting Note: This paragraph of the Preamble became effective Jan. 1, 2016]
- 2) Variable annuities valued under Actuarial Guideline XLIII—CARVM for Variable Annuities (AG 43). [Drafting Note: This paragraph of the Preamble is not yet effective. Effective date for compliance to be determined.]
- 3) Long term care insurance valued under the *Health Insurance Reserves Model Regulation* (Model #10). [Drafting Note: This paragraph of the Preamble is not yet effective. Effective date for compliance to be determined.]

The NAIC Executive (EX) Committee adopted the XXX/AXXX Reinsurance Framework, and the NAIC is currently in the process of adopting actions necessary for its full implementation. With regard to a captive insurer, special purpose vehicle, or any other entity assuming XXX/AXXX business, regulation of the entity is deemed to satisfy the Part A accreditation requirements if the applicable reinsurance transaction satisfies the XXX/AXXX Reinsurance Framework requirements adopted by the NAIC.

[Drafting Note: The Part A standards with respect to entities assuming variable annuities and long term care reinsurance business are intended to be effective with respect to both currently in-force and future business. However, the effective dates for variable annuities and long term care insurance are not yet determined, and their application to in-force business need further discussion].

Other Types of Insurers

For clarity purposes, the scope of the Part A standards excludes regulation of those insurers licensed as fraternal orders and title insurers. The scope of the Part A standards also excludes regulation of health organizations, except that compliance with the “Capital and Surplus Requirement” standard is required for entities licensed as health organizations (including health maintenance organizations, limited health service organizations, dental or vision plans, hospital, medical and indemnity or service corporations, or other managed care organizations) to the extent the insurance department regulates such entities. This definition does not include an organization that is licensed as either a life/health insurer or a property/casualty insurer, which are subject to the full Part A accreditation standards.

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* and the *Risk-Based Capital for Health Organizations 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) Insurance Holding Company Systems

State law should contain the NAIC *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 that is substantially similar to the NAIC *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 *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 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 and licensing of domestic insurers.

20) Risk Management and Own Risk and Solvency Assessment

State law should contain the NAIC *Risk Management and Own Risk and Solvency Assessment Model Act* or a substantially similar law.

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 Organized as Captives**Scope of the Part A Standards (Risk Retention Groups Organized as Captives)**

The following Part A standards apply to regulation of a state's domestic RRGs incorporated as captive insurers, but only if the RRG is a multi-state insurer. For purposes of Part A, an RRG that meets any of the following conditions is considered to be a multi-state insurer and subject to the Part A standards:

- 1) An RRG domestic insurer that is registered in at least one state other than its state of domicile.
- 2) An RRG domestic insurer that is operating in at least one state other than its state of domicile.
- 3) An RRG domestic insurer that is reinsuring business covering risks residing in at least two states.

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. The *Risk-Based Capital 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 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 an 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) Insurance Holding Company Systems

State law should contain the NAIC *Insurance Holding Company Systems 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 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 that is substantially similar to the NAIC *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 *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.

18) Governance

State statute or regulation should contain a requirement for governance standards of domestic RRGs that is substantially similar to the NAIC *Model Risk Retention Act*.

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 for Part B

Purpose of the Part B Standards

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 multi-state insurers as discussed below. The term "state" as used herein is intended to include any NAIC member jurisdiction, including U.S. territories.

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, and to some extent the evaluation by private rating agencies.

Scope of the Part B Standards

The scope of Part B is broader than the scope of Part A as Part B encompasses nearly all forms of insurers domiciled or chartered in the accredited state, but only if the insurer is a multi-state insurer. The term "insurer" in Part B includes regulation of a state's domestic insurers licensed and/or organized under its life/health and property/casualty statutes, those insurers licensed as fraternal orders and title insurers, risk retention groups organized as captive insurers, those insurers licensed as health organizations (including health maintenance organizations, limited health service organizations, dental or vision plans, hospital, medical and indemnity or service corporations or other managed care organizations, but only to the extent the insurance department regulates such entities), 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 Part B, an insurer (other than a non-RRG captive insurer) that meets any of the following conditions is considered to be a multi-state insurer subject to the Part B standards:

- 1) A domestic insurer that is licensed in at least one state other than its state of domicile.
- 2) A domestic insurer that is registered in at least one state other than its state of domicile.
- 3) A domestic insurer that is operating in at least one state other than its state of domicile. A
- 4) A domestic insurer that is accredited or certified as a reinsurer in at least one state other than its state of domicile.
- 5) A domestic insurer that is reinsuring business covering risks residing in at least two states.
- 6) A domestic insurer that is accepting business on an exported basis as an excess or surplus line insurer in at least one state other than its state of domicile.

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.

Part B1: Financial Analysis

a) Sufficient Qualified Staff and Resources

The department should have the appropriate staff and resources to effectively and timely review the financial condition of all domestic insurers.

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

The department should ensure that all relevant information and data obtained that may assist in the financial analysis process is provided to the financial analysis staff. The department should ensure that findings of the financial analysis staff are communicated to the appropriate person(s) within the department.

c) Appropriate Supervisory Review

The department's financial analysis process should provide for appropriate supervisory review and comment. Supervisory review may be conducted by the analyst's supervisor or a senior level analyst whose job functions include such review duties.

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~~ The prioritization scheme should follow the guidelines and classifications outlined in the NAIC *Financial Analysis Handbook* and utilize appropriate factors as guidelines to assist in the consistent determination of priority designations.

e) Documented Analysis Procedures

The department should ~~generally follow the risk-focused~~ have documented financial analysis procedures and/or guidelines to provide for consistency and continuity in the process and process outlined in the NAIC *Financial Analysis Handbook* to ensure that appropriate analysis procedures are performed on each domestic insurer and insurance holding company system, as applicable to either the domestic regulator or lead state depending on the filing.

f) Appropriate Depth and Quality of Review

The department's financial analysis should ensure that domestic insurers and insurance holding company systems for which the department serves as the lead state receive a high quality review at an appropriate depth commensurate with their financial strength and position, and risk profile.

g) Reporting of and Action on 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. 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.

Part B2: 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 ensure that all relevant information and data obtained that may assist in the financial examination process is provided to the financial examination staff. The department should ensure that findings of the financial 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) General Examination 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) Risk Assessment and Testing

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 and coordinated basis. This system should accord priority to companies that exhibit adverse financial trends or otherwise demonstrate a need for examination.

h) Communication of Examination Results

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

Part B3: Department Procedures and Oversight

a) Information Sharing

States should have the authority to share confidential information with other state, federal, and international regulatory agencies and law enforcement authorities, and the NAIC. States should have the authority to maintain the confidentiality of information received from these parties. Further, the states should demonstrate the willingness to act on this authority to share confidential information.

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.

c) Department Oversight

Department management should be involved in solvency monitoring activities for its domestic industry to ensure appropriate oversight of staffing, company interactions and key solvency issues with the ability and willingness to take action, as deemed appropriate.

PART C: ORGANIZATIONAL AND PERSONNEL PRACTICES

a) Professional Development

The department should recognize and provide necessary training needs for staff involved with financial surveillance and regulation. The department should also have a policy that encourages professional development through job-related college courses, professional programs, and/or other training programs.

b) 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.

c) Retention of Personnel

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

d) Use of Contract Personnel

A department that utilizes contract personnel to assist in financial surveillance and regulation should ensure that those hired in the capacity of a contractor are subject to standards that are comparable to or exceed those standards applicable to employees of the state.

PART D: ORGANIZATION, LICENSING AND CHANGE OF CONTROL OF DOMESTIC INSURERS

Preamble for Part D

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.

a) Sufficient Qualified Staff and Resources

The department should have the appropriate staff and resources to effectively and timely review applications for primary licensure and Form A filings for all domestic insurers.

b) Scope and Performance of Procedures for Primary Applications

The department should have documented licensing procedures to provide for consistency in the review process and to ensure that appropriate procedures are performed on all primary applications.

c) Scope and Performance of Procedures for Form A Filings

The department should have documented procedures for the review of Form A filings to provide for consistency in the review process and to ensure that appropriate procedures are performed on all Form A reviews.