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3505 Vernon Woods Drive
Summerfield, NC 27358
Tel 336.365.4640
Fax 336.644.6205

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CRE READING PROGRAM INSTRUCTIONS

The Society of Financial Examiners has a Reading Program for Earning Continuing Regulatory Education Credit by Reading the Articles in The Examiner.

You can earn **2 CRE credits** for each of the 4 quarterly issues by taking a simple, online test after reading each issue. There will be a total of 15-30 questions depending on the number of articles in the issue. The passing grade is 66%. To take the test, read all of the articles in the issue. Go to the Members section of the SOFE website to locate the online test. This is a password-protected area of the website, and you will need your username and password to access it. If you experience any difficulty logging into the Members section, please contact **sofe@sofe.org**.

NOTE: Each new test will be available online as soon as possible within a week of the publication release. The Reading Program online tests are free. Scoring is immediate upon submission of the online test. Retain a copy of your online test score in the event you are audited or you need the documentation for any other organization's CE requirements. Each test will remain active for one year or until there is a fifth test ready to be made available. In other words, there will only be tests available for credit for four quarters at any given time.

Earn Continuing Regulatory Education Credits by Reading The Examiner!

The questions are on the following page. Good luck!

Earn Continuing Regulatory Education Credits by Reading *The Examiner!*

CRE Reading Program Questions

All quizzes MUST be taken online.

*Questions will be **available online July 13, 2020.***

Making Ethics Work in Risk-Focused Examinations

Multiple Choice and True or False Questions — Submit Answers Online

1. Examiners are exempt from pressures to perform examinations as quickly and efficiently as possible.

   a. True
   b. False

2. The SOFE Code of Ethical Conduct requires examiners to carry out their examinations in a manner to be worthy of the confidence of the people which includes the regulators and the public at large.

   a. True
   b. False

3. Ignoring facts may allow you to finish an examination quickly, but does not support the maintenance of public confidence.

   a. True
   b. False

4. If issues and discussions with regulators and the Company cannot be resolved satisfactorily, you should document it and agree to disagree.

   a. True
   b. False

5. All of the following are principles of the SOFE Code of Ethical Conduct, except for___:

   a. Confidentiality - Members must maintain the privacy and confidentiality of information acquired as a result of professional and business relationships, and therefore not disclose any such information unless disclosure is legally permitted, nor use the information for personal advantage of the member or third parties.

   b. Integrity - Members, at all times, must demonstrate the qualities of honesty and trustworthiness.

   c. Objectivity - Members must maintain objectivity and be free of conflicts of interest in discharging their professional responsibilities. Members must not allow bias, conflict of interest, or undue influence of others to override their professional or business judgments.

   d. Professional Behavior - Members must comply with relevant laws and regulations and avoid any action that discredits themselves or the Society of Financial Examiners. Members must not use, or attempt to use, their official position to obtain improper privileges or exemption for themselves or others.

   e. Professional Competence and Due Care - Members must maintain professional knowledge and skill based on the current developments in practice, legislation, and techniques. Members are responsible for performing their job duties to the best of their ability using due diligence and in accordance with applicable professional standards.

   f. All of the above

Conducting Efficient Risk-Focused Examinations with NAIC Guidance

True or False Questions — Submit Answers Online

6. Reliance on analysts contributes to a more inefficient examination.
   a. True
   b. False

7. Examiners should rely upon the confirmation testing performed by the CPAs, where applicable, or explicitly document the rationale for not placing reliance.
   a. True
   b. False

8. There is correlation between reliance on the work of CPAs and the quantity of workpapers imported.
   a. True
   b. False

9. Prospective risks identified on Exhibit V should be investigated for appropriate risk mitigation during Phase 5 of an examination.
   a. True
   b. False

10. Significant exam documents should be worked on as early as possible.
    a. True
    b. False

NAIC 2020 Spring Meeting Highlights and NAIC Interim SAPWG Adoptions-Relief is Here!

True or False Questions — Submit Answers Online

11. The NAIC SAPWG will not require Companies to record loss adjustment expense liabilities if it is a prepayment to third parties.
    a. True
    b. False

12. Event cancellation and travel insurance policies will be significantly impacted due to COVID-19.
    a. True
    b. False

13. Business Interruption Coverage will be highly impacted due to COVID-19.
    a. True
    b. False

14. The NAIC SAPWG has granted temporary extension to the Ninety-Day Rule due to COVID-19. This includes premiums receivable from policyholders or agents, uncollected uninsured plan receivables, life premium due and high deductible receivables.
    a. True
    b. False

15. The Temporary Interpretations adopted due to COVID-19 are only in effect for the first and second quarter of 2020. The NAIC SAPWG will wait to determine if an extension for the COVID-19 related interpretations is necessary.
    a. True
    b. False

Insurance Collaboration is a Captivating Idea

Multiple Choice and True and False Questions — Submit Answers Online

16. The onset of the COVID-19 pandemic revealed that insurance buyers often believe they have adequate insurance coverage.

    a. True
    b. False

17. The insurance industry has done the following to fund catastrophe exposures, such as hurricane, tornado, earthquake, and flood:

    a. Collaborate with the reinsurance market and with the capital market (via insurance-linked securities)
    b. Make insurance for terrorist events available as a federal backstop
    c. Develop parametric insurance, which can provide widespread insurance based on the trigger of certain-sized catastrophic events
    d. Both A & B

18. Many workers deemed "essential" who have exposed themselves to the virus (e.g. grocery store clerks), will have a very simple standard to prove that COVID-19 is a compensable occupational disease under workers' compensation state laws.

    a. True
    b. False

19. The proliferation of captive insurance companies in the last 35 years suggests that commercial insureds are ready to take on their own insurance risks when:

    a. Commercial insurers don't want to, or will not offer coverage
    b. Insureds would like to actively manage their own risks and reduce costs
    c. Large entities are trying to offer insurance directly to customers
    d. All of the above

20. Which of the following is an idea for insurers to work more seamlessly with their customers:

    a. Gather all interested parties to discuss how captives can be used for the quicker adoption of cost-reducing technologies, and where parametric insurance can bring a cleaner solution to potential large-scale interconnected risks.
    b. Allow insuretechs to leverage artificial intelligence and machine learning technologies to quickly identify areas of coverage gaps
    c. Educate auditors to be more conversant in various insurance issues and mechanisms to improve customer understanding of insurance
    d. All of the above

Risks in Pricing Life, Health and Property & Casualty Insurance Products

True or False Questions — Submit Answers Online

21. Pricing risk is not considered to be a prospective risk that may impact the financial condition of an insurance entity.

    a. True
    b. False

22. Life insurance products and related risks tend to be short-term in nature.

    a. True
    b. False

23. When an insurer prices its health coverage policies, a key risk to consider is the projected likelihood of illness and the related cost of a claim.

    a. True
    b. False

24. For property and casualty insurance, when assessing whether or not the insurer's pricing adequately accounts for related risks, a key area to review during a risk focused examination is the level of communication between the areas of claims, underwriting, and actuarial.

    a. True
    b. False

25. Given the recent COVID-19 pandemic event, and for purposes of performing an Actuarial Rate indication analysis, the issue of claims not anticipated in coverage would not be considered a factor to consider for the analysis.

    a. True
    b. False

Making Ethics Work in Risk-Focused Examinations

By Lewis D. Bivona, Jr. CPA, AFE
Assurity Resources, Inc.

While examiners are quite familiar with current risks that plague insurers, we are not always sure about the decisions we make related to perceived examination risks and their potential ethical impacts. Disturbing yes, but your ethical decisions are not the only cause for concern as the auditors whose work you are relying on face their own ethical hurdles in preparing for and

In a study performed by University of Arkansas entitled "Don't Make Me Look Bad: How the Audit Market Penalizes Auditors for Doing Their Job" (1) the authors examined the reputational impact of an audit office issuing internal control material weaknesses (ICMW). The authors noted that prior research examined how clients that receive an ICMW respond, they focused on clients that receive clean internal control opinions. The authors predicted and found that audit offices that issue more ICMWs experienced lower client and fee growth.

Other findings of the study included:

- Decreases in fees and retention are stronger when the ICMW is associated with a more visible client and when the ICMW is more severe.
- Supplemental analyses found evidence consistent with clients avoiding auditors with a reputation for issuing ICMWs in their auditor selection decisions.
- On average, the market for audit services penalizes auditors for disclosing information critical of management in their audit opinions, which undermines the value of direct-to-investor auditor communications and provides insight into potential longer-term implications of the recently enacted expanded auditor's report.

Considering the above factors in your next examination a company's risk is paramount. Several factors to look at as you evaluate and consider using the work of the auditors are:

- How long has the current auditor been with the insurer
- What if any, ICMW's were found in any of the audit reports you have reviewed
- Have there been any material changes in the fees charged by the auditors
- Has the Company changed their auditors recently: and if so why? As a sidebar, in interviews with the BOD, Audit Committee or Internal Auditors you should make inquiries regarding reasons for the change.
- Were audit staff consistent over the examination period or was there a major reassignment of personnel.

Considering the potential impacts of failed disclosures of ICMWs in your risk planning should cause examiners to reflect on potential weaknesses in controls and how to address them in the seven phases of the exam.

Examiners are also not exempt from pressures to perform examinations as quickly and efficiently as possible. With these pressures come subtle but influencing factors such as will the State continue my employment or if you

are a contracted examiner your continued utilization? Is the insurer so big in the State that key reviewers/stakeholders do not want any controversies or findings revealed? Is the insurer a major contributor to federal, state or local politicians that could cause political pressures to bury findings? When in doubt, examiners should remember that they are bound by the Society of Financial Examiners Code of Ethical Conduct, which was amended and restated as of July 2020 as follows:

SOFE Code of Ethical Conduct

Society of Financial Examiners membership is voluntary. By accepting membership, members assume the obligation of adhering to this Code of Ethical Conduct in accordance with the SOFE Restated Bylaws. SOFE has adopted this Code of Ethical Conduct to provide guidance to all members in the performance of their professional responsibilities. SOFE members must adhere to the following five principles at all times during their membership.

- ✓ **Integrity** - Members, at all times, must demonstrate the qualities of honesty and trustworthiness.
- ✓ **Objectivity** - Members must maintain objectivity and be free of conflicts of interest in discharging their professional responsibilities. Members must not allow bias, conflict of interest, or undue influence of others to override their professional or business judgments.
- ✓ **Professional Competence and Due Care** - Members must maintain professional knowledge and skill based on the current developments in practice, legislation, and techniques. Members are responsible for performing their job duties to the best of their ability using due diligence and in accordance with applicable professional standards.
- ✓ **Confidentiality** - Members must maintain the privacy and confidentiality of information acquired as a result of professional and business relationships, and therefore not disclose any such information unless disclosure is legally permitted, nor use the information for personal advantage of the member or third parties.
- ✓ **Professional Behavior** - Members must comply with relevant laws and regulations and avoid any action that discredits themselves or the Society of Financial Examiners. Members must not use, or attempt to use, their official position to obtain improper privileges or exemption for themselves or others.

Members, at all times, must adhere to the Society of Financial Examiners' Oath regarding tests and examinations, incorporated by reference into this Code.

Actions for disciplinary sanction for violations of this Code of Ethical Conduct may be brought before the Board only by a member of the Professional Standards Committee.

While examiners cannot affect the performance or non-performance of outside parties, we can self-monitor our decisions based upon the SOFE Code of Ethical Conduct. How would you react to the following scenarios if they presented in your examination? The key ethical concepts that I always consider are am I being responsible to the public and the state during the conduct of the examination, I am I being asked to ignore a law or regulatory responsibility, and am I discharging my duties to the merit of the public and the regulatory agency that retained me. The following are five examples that I had encountered in my 30 years of preforming regulatory examinations:

Example # 1: A national insurer with an examinee in your state was noted as not paying claims in a national news source which referenced a key company executive from a bordering state as the whistleblower. When questioning management about this issue, they do not answer but refer you to their attorney who says that due to confidentiality, they cannot disclose the settlement of the matter with that executive or disclose the separation payment made to same. Although they say the case was without merit you noted a substantial subsequent year bulk payment to a number of providers which is above your current examination materiality calculation. While sharing this potential adjustment with the Company, they made it known that they are going to lobby the Insurance Department to waive they adjustment, what would you do?

Example # 2: During an examination you find that actuarial calculations were managed by the Company as they had a different sets of internal claims statistics that were materially different from the statistics that they provided to their external consulting actuaries. The claims differences exceeded materiality calculated for the examination and if booked if booked correctly would have resulted in refunds to members because of MLR requirements. You also note that the opining actuary has threatened to disengage from the Company yet the State's EIC who is also a CFE does not seem overly concerned, what would you do?

Example # 3: A key examination contact has told you that the State is not interested in finding any issues with the top health insurer in their state. Preliminary evaluations have noted that identified issues may exceed calculated materiality. Should you as the examiner adjust confidence levels to increase materiality thresholds to provide the clean report?

Example # 4: Same facts as #3 but you also noted that key politicians were given either direct campaign contributions or indirect material contributions to familial charities. The same politicians are noted as pressuring the Department to grant major rate increases which do not appear warranted by claims trends or actual claims payments, what would you do?

Example # 5: While working on an examination, you realize that you charged a material amount to one state for time that should have been charged to another state's examination, what would you do?

Remember that the Code of Ethical Conduct requires examiners to carry out your examination to be worthy of the confidence of the people which includes the regulators and the public at large! Ignoring facts may allow you to finish an examination quickly but does not support the maintenance of public confidence. When in doubt, refer to the Code of Ethical Conduct and take appropriate actions. Document your issues and discussions with regulators and the Company and if they cannot be resolved satisfactorily it is imperative to move those discussions to the next higher level of oversight or if all else fails, refer a major departure to the SOFE Professional Standards Committee and the NAIC.

Author's Answers

Example # 1: Prior period developments of claims payments that were disavowed by Company management should be included in the report as adjustments to Company reported results. Materiality should not be adjusted to cover up potential material findings. The Examiner should discuss the findings with the State to determine if actions are anticipated to correct and prevent future management of earnings and transparency with the Department.

Example # 2: This appears to be a major internal control weakness if not outright fraud since the Company has misrepresented key information which it has supplied to its external consulting actuaries which opined on the validity of the reserves. Since MLR is misrepresented this is a violation of the current federal MLR requirements as well. Examiners should make note of key facts in the report and adjust the financials accordingly in spite of pressure not to report. If the State modifies your report to ignore the finding, you should consider referring to SOFE and/or the NAIC for review.

Example # 3: The sheer fact that a key stakeholder has told the examination team that they are not interested in finding anything wrong with a particular insurer could be viewed as a potential scope limitation. The examiner should not increase materiality to cover up potential material findings that are not supported by findings of fact based upon review and testing of controls and/or transactional tests, if required.

Example # 4: This one is a tough one because kickbacks indicate the you probably live in a politically corrupt state if quid pro quos are the driving modus operando. Hopefully the Department will allow these findings to go public. In our case, the State was concerned about the matter and referred our concern to the State Attorney General who handled the case from there.

Example #5: While a correction for a billing error is a pain, honesty is the best policy. Your integrity covers all aspects of the examination and the misbilling should be explained and adjusted for both parties.

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1. Cowle, Elizabeth and Rowe, Stephen P., Don't Make Me Look Bad: How the Audit Market Penalizes Auditors for Doing Their Job (September 10, 2019). Available at SSRN: https://ssrn.com/abstract=3228321 or http://dx.doi.org/10.2139/ssrn.3228321

About the Author

Lewis D. Bivona, Jr., **CPA, AFE**, currently functions as a Market Regulation Examiner and a Financial Condition Examiner for Assurity Resources where his primary responsibilities include conducting and reviewing the practices and financial solvency of health and property and casualty companies. Prior to joining Assurity, Lewis was an SME for another major examination outsourcing firm. Prior to that he was the insurance practice partner for a large east coast regional firm which performed certified audits, financial condition examinations for various state insurance departments and targeted/due diligence examinations. Mr. Bivona also served as a deputy rehabilitator and/or liquidator for several insurance companies. Early in his career Lewis was a regulator for the HMO industry in New Jersey. Lewis has served on the NAIC/AICPA Insurance Liaison Committee, SOFE Examiner Publication Committee and NAIC Accreditation Committee. Mr. Bivona is a published author on insurance topics in several insurance outlets including Best Magazine, Insurance and Business, Employer Benefits and the SOFE Examiner where he won the Editor's Choice Award in 2014.

Conducting Efficient Risk-Focused Examinations with NAIC Guidance

By Alex Pirie
CPA, CFE, CMA, CIA, CFE (Fraud)
and Conor Scannell, AFE
Risk & Regulatory Consulting, LLC

Collectively, we have had relatively brief careers compared to some of the more senior members of SOFE. As luck would have it, one of us has had the luxury of working on the perfect exam. The company was responsive and all of the documentation provided was detailed, organized, and replete with more footnotes, graphs, and explanations than the average college textbook, though not nearly as fun to read. The exam team members and specialists were of the highest caliber. The actuarial specialist was familiar with TeamMate and documented his work in the file on a real-time basis! The IT specialists completed their work early and under budget. In fact, there was only one issue during the entire exam. Just as I was handing over the final report to the client, I began shaking while someone shouted, "Wake up, you're drooling all over the keyboard!" The ephemeral 'perfect exam' had been nothing more than a dream…

The reality is that there is no such thing as the 'perfect exam.' Should anyone tell you differently, either pinch yourself or tell him or her to "Wake up!" (Note: The authors do not condone pinching others). Having problems arise during an examination are as inevitable as death, taxes, and emails from the EIC telling you that you forgot to enter your time again. During one especially turbulent examination, one of us was loudly outlining our argument for why that particular exam was the worst in the history of exams to a colleague when she burst out laughing. Specifically, it was in response to the comment that, "In all my years, I've never seen anything like this!" She assured me that no matter what troubles I was having, another examiner had already been through it and worse.

We decided to set about asking the question to more experienced examiners about suggestions, advice, and anecdotes on how to run an efficient exam and what to do when things inevitably do not go as planned. We could never hope to capture the aggregated knowledge and experience of even one examiner short of a biopic. However, there were a handful of common threads noted in the responses, which we hope others will find as enlightening as helpful as we have. The topics are as follows:

1. Efficient Mindset
2. Reliance on Analysts
3. Reliance on CPAs
4. Interviews
5. Risk Tracking and Testing
6. Major Examination Documents

Efficient Mindset

When we first came across the suggestion of having an 'efficient mindset,' our natural instinct was to roll our eyes into the back of our heads; are there really examiners out there that consciously have an 'inefficient mindset?' The more we talked to others about this, though, the more we came to appreciate how the simplicity of the message belied its importance. Having an efficient mindset means breaking old habits and reallocating resources..

Breaking out of old habits can be particularly difficult. After all, 'if it ain't broke, don't fix it?' This old adage underpins the vexation experienced by anyone seeking to champion change. As an alternative, the approach should be to first define the ultimate goal. From there, you should consider the best method for achieving that goal in a vacuum, i.e. without considering precedent. At a minimum, you should be able to offer a logical rationale for why one method is better or more efficient than the alternative and be open to suggestion(s).

Good Example: "Entering your time daily helps the EIC understand if the examination is on track to complete within the budget and timeframe."
Bad Example: "Get your time entered – BECAUSE I SAID SO!"

Reliance on Analysts

Early in one our careers, one of us was told, "Behind every great examination is a great analyst." In hindsight, he may have been a little biased, given that he was an analyst himself. Of course, he also liked to joke that, "Behind every great analyst is good prior examination documentation." It has taken us several years to fully appreciate the truth embedded in his joke about the symbiotic relationship between examiners and analysts. This sentiment was shared by many of the examiners we talked to, who noted that having a comprehensive agenda (such as the newly added Exhibit D), placing reliance on the analysts for the analytical review, and general avoidance of work duplication are just some of the ways that reliance on analysts can contribute to a more efficient (and great!) examination.

As we are both relatively new to the examination process, we are constantly asking fellow examiners for standard workpaper templates they may have, including agendas. We have seen some incredible agendas for the initial analyst meeting, yet we are confident that even the most experienced examiner could benefit from the newly added Exhibit D. Having a formal agenda of topics to cover during the planning meeting with the financial analyst is an invaluable resource. Given the plethora of information available from analysts and the ready-made format of Exhibit D, we encourage examiners of all experience levels to leverage this agenda during the initial planning meeting with the analyst to ensure you are getting the most out of the meeting.

Good Example: "Exhibit D is a valuable resource for ensuring we maximize our time with the analyst during the planning meeting and to request all available information prior to the start of the examination."
Bad Example: "The analyst said there were no updates from the prior examination, and we have a generic preliminary request we send the company, so I did not bother using Exhibit D."

Early experiences being on some exam teams left us with the impression that analysts were not to be bothered because examiners seemed so reluctant to 'bother' them. To the contrary, experience has shown us analysts share our same zeal for examinations and learning about companies and are delighted at the prospect of someone actually reading and relying upon their work. Given the preponderance of analysis performed by an Analysts on a near daily basis, it stands to reason that their analytical review of the company would be more detailed, informative, and efficient than any that would be performed by the examiner.

Good Example: "We can leverage the analytical review performed by the analyst to help direct our inquiry and identification of significant risks during planning."
Bad Example: "I don't want to bother the analyst, so just put together a quick analytic to satisfy the exam procedure."

Another common misconception is that companies tend to resent analysts and/or insurance departments due to the relentless regulations and questions. In actuality, many analysts have a positive relationship with company contacts, in large part because of the frequent interaction. Examiners interact with a company's management team for a few weeks or months at a time, once every 5-years, whereas analysts are in touch with them at least quarterly. As analysts are shifting towards a more risk-focused approach (similar to risk focused exams), now more than ever, they are an invaluable fountain of information about the companies being examined, and take pride in sharing what they know. As one examiner we spoke with eloquently stated, "they have answers to questions that I had not even thought to ask!"

Good Example: "We should meet with the analyst and ask for copies of any correspondence they have had with the company during the period under examination to avoid any duplication of effort."
Bad Example: "We should treat the company's senior management as though they are interacting with an independent third-party for the first time, ever. Trust nothing; question everything!"

Reliance on CPAs

Finding a comfortable middle-ground using CPA workpapers can sometimes be a challenge. The underlying philosophy seems to be one of all or nothing; the examiners either imported the entire CPA file into TeamMate, or independently reperform a majority of the testing, despite documenting that they were able to take reliance on the work of the external auditors during planning. The most common misconceptions around the use of CPA workpapers noted during our survey included confirmation testing, reduction of financial reporting risks, and using discretion as to what workpapers to include in the file.

The topic that the examiners we spoke with were most passionate about would have to be confirmation testing. Given the prevalence of the practice, we were surprised to learn that none of the examiners responses advocated for sending independent confirmations when the CPAs had already performed confirmation testing. As a best practice, examiners should rely upon the confirmation testing performed by the CPAs, where applicable, or explicitly document the rationale for not placing reliance.

Good Example: "We determined during Planning that we could place reliance upon the work of CPAs, so we can rely upon the confirmation testing they already performed, and send additional confirmations for any areas not covered by the CPAs."
Bad Example: "We need to confirm the confirmations received by the CPAs."

Anyone that has been onsite in an exam room for at least a day is guaranteed to have heard two phrases: "To reduce financial reporting risks" and "Can we lower the risk to Moderate?" (Note: The answer is always "no"). The other thing that these phrases have in common is that while they both seek to lower the amount of testing performed, pursuit of these strategies often leads to arbitrarily increasing the amount of documentation. When placing reliance on the work performed by the CPAs for financial reporting risks, this reliance should be explicitly documented in a memo, such as the Audit Function Review Memo and the Engagement Planning Memorandum ("EPM"). Once the reliance is documented, it is not necessary to address these risks in Phase 3 or import the underlying CPA workpapers into the TeamMate file – provided they are inherently assessed as Moderate and do not fall under the Critical Risk Categories in Exhibit DD.

Good Example: "We documented in the EPM the financial reporting risks and areas for which we will be relying on the work of the external auditors, so those risks should not be included on the risk matrices, and it is not necessary to import those workpapers into the TeamMate file."
Bad Example: "The Examination TeamMate file should indiscernible to the external auditors file, because examiners should import all of the CPA workpapers, regardless of relevance to risks documented on the risk matrices, and rephrase the documentation to be in their own words."

It turns out you don't need to be a superhero to save time and space (in a TeamMate file, at least); all that's required is the use of judgement about which CPA workpapers to upload. The prevalence of CPA workpapers in old TeamMate files can be likened to the experience of walking into older homes with a plethora of wallpaper and carpeting; you look around, mouth-agape, thinking to yourself "why did they you use it EVERYWHERE?" Just as the modern aesthetic has evolved to more open-concept and hard-wood floors, the philosophy of TeamMate files is similarly evolving. Examiners should keep in mind that there is no correlation between reliance on the work of CPAs and the quantity of workpapers imported. All significant testing and documentation should be reviewed, especially in areas where examiners plan to place reliance on the work of the CPAs. However, only relevant summary workpapers should be retained in the TeamMate file, with concise documentation.

Good Example: "The CPAs documented the purpose, procedure, attributes, and conclusion on these summary control test matrices. Let's review the documentation referenced in each, but only bring in the summary workpapers. We should also only import the ones that directly relate to risks identified on our KFAs."
Bad Example: "The CPAs tested 150 payroll selections. This doesn't relate to any of our KFAs, but the documentation is great, so we need to find a place to import all of this documentation into the file."

Interviews

Management interviews, if done correctly, can provide the exam team with an invaluable opportunity during Phase 1 to hold meaningful conversations with members of management about the state of the insurer. C-level employees possess a wealth of information regarding the insurer's strategic direction, corporate culture, internal operations, and most importantly, top risks. The key to the interview process is unlocking this information. The question is; how do we get there?

Every examiner at one point or another has spent hours of their lives typing up interview notes. While this task is known to be one of the most exciting in the industry, maybe even a personal favorite for some, there is a way to lessen the burden! There is no rule requiring the exam team to interview every employee in the C-suite. While it is easy to pick out the top row of an organization chart as targets, consider determining managers of key risk areas or those that have undergone significant changes during the exam period.

Good Example: Although the Chief Claims Officer reports directly to the CEO, let's save them as an option for a subject matter expert interview since the CPAs did not note any issues in this area.
Bad Example: Based on the organizational chart and the interviews listed in Exhibit Y of the Handbook, we should interview these 12 employees.

On a similar note, consider eliminating unnecessary interviews with those who may not hold the appropriate breadth of knowledge of the company's operations. Remember that subject matter experts can always be interviewed during later phases of the examination when there are questions surrounding specific processes or testing procedures. These meetings in Phase 1 should help to provide a more holistic view of how the company is managed and allow the examiners to get an understanding of the corporate culture and strategy. As such, those employees that reside multiple levels down from the C-suite may not be as involved in these discussions and would not provide as much value to the examiners. If time is limited, another option would be to invite a subject matter expert to a C-level interview to provide additional color in areas where the C-level employee may not be as involved.

Good Example: Let's combine the Chief Financial Officer and Chief Accounting Officer interviews to make the most of our limited time onsite.
Bad Example: The Head of the Tax Department is on the first page of the organizational chart so we should include them in the first round of interviews.

One of the best ways to ensure our limited time with these executives produces purposeful information is to stray from generic questions. At the end of the day, generic questions lead to generic answers. I'm sure we've all sat through numerous interviews where the interviewee wants to talk for 20 minutes about their educational background! Even when interviews take place relatively early during Phase 1, the exam team would have had time to review public information and preliminary information responses from the company. Examiners should utilize this information already gathered during Phase 1 to pose detailed and pointed questions during the interview process. This also presents a psychological advantage during interviews, as members of management will recognize the examiner's knowledge of the entity and may lower their use of broad 'corporate' language in their responses. While sources like Exhibit Y of the Handbook present good starting points, examiners should not be afraid to stray from the more standard interview questions.

Good Example: "We noticed the company recently started writing a new line of business. Can you speak to the risk assessments and strategic discussions that went into that decision?"
Bad Example: "What are the company's plans to grow business?"

As a final point, the order of interviews can play an important part in the identification of significant risks facing the insurer, as well as understanding the enterprise risk management function ("ERM") surrounding them. During the 2019 Financial Condition Examiners Handbook Updates & Hot Topics session, the NAIC noted that guidance is being considered for inclusion regarding the order of interviews. As a best practice, it is recommended that

the exam team begin with the Chief Risk Officer ("CRO") or the individual in charge of ERM, then work through management and end with the Chief Executive Officer ("CEO"). With this approach, the examiner knows from the start the process all C-level employees should be going through to identify, mitigate, and monitor risks. While trying to schedule interviews sometimes seems as hard as getting all the members of Fleetwood Mac in the same place, striving for this order can provide instrumental knowledge of the insurer's risk management process before speaking with those responsible for managing the risks day to day.

Good Example: Sending the company contact the ideal interview order and working with them to find the best schedule.
Bad Example: Sending the company a list of interviewees and hoping for the best.

Risk Tracking and Testing

Following discussions on these various sources of risks, it is crucial to have an understanding of how risks flow through the examination process, as well as the ways examiners can efficiently track them. This is where Exhibit CC comes into play. Often times with multiple team members reviewing heaps of Phase 1 documentation, risks can fall through the cracks. During the exams we have worked on, the EIC has ensured the Exhibit CC template is one of the first documents uploaded to the project. This practice allows the exam team to populate the Risk Tracker early and often. Even when you are unsure if a risk is significant enough to carry forward, you can document the risk in Exhibit CC with the knowledge that it can be assessed as 'non-key' during Phase 2 before being carried forward to a Key Functional Activity ("KFA" or Exhibit V. By doing so, there is less of a chance that a key risk is left uninvestigated.

Good Example: "Although I'm unsure of the impact emerging accounting standards may have on the Company, I should document the risk on Exhibit CC and investigate further."
Bad Example: "I am not sure if this risk would make it to a KFA Risk Matrix, so it is probably not worth putting on Exhibit CC."

After Phase 2, the exam team should have a sound view of the insurer's risk profile. Many of the risks identified during Phase 1 will have found their way to Exhibit V as prospective risks. Of course, Exhibit V is unique in its timing, as the risk mitigation testing for prospective risks is not aligned with the regular exam phases. The exam team is free, and encouraged to, investigate these prospective risks as soon as possible regardless of the status of control and substantive testing within the KFA matrices. During a 2018 NAIC Peer Review session, six out of six exams were flagged for treating Exhibit V as a Phase 5 procedure. The recommended takeaway guidance was to investigate these risks early, and to give them as much, if not more, attention than those on KFA matrices depending on their potential solvency impacts. Additionally,

prospective risks can provide the exam team with work during downtime. The review of these risks comes in handy during lulls between phases, or when the insurer inevitably requests a 3 week extension to get you information for the KFA risks!

Good Example: "Since we've already identified succession planning as a prospective risk, we can send out information requests now in the early stages of Phase 3."
Bad Example: "Since succession planning is on Exhibit V, we should wait until the end of the exam to investigate the risk."

The topic of prospective risk testing leads directly into the next, which involves the depth of testing per risk. During the same NAIC Peer Review session, multiple exams were flagged for lack of in-depth testing over the most significant risks of the exam. It was made clear that all risks during an exam do not warrant equal amounts of attention, and that examiners are encouraged to spend more time on those risks which pose the greatest solvency threats to the insurer. This guidance encompasses both KFA and Exhibit V risks.

Good Example: "The prospective risk related to the insurer's CAT exposures are significant, so we should spend additional time reviewing risk mitigation techniques."
Bad Example: "We've already reviewed the first round of information provided by the insurer, so we can document that and call it a day."

Technology is advancing at an unparalleled pace; the average examiner taking the AFE and CFE exams has likely never known a world without cell phones and the Internet. This means they are also likely too young to remember many of the significant recessions of recent years and the underlying causes. Experience can help anticipate risks based on historical precedent, but it is of less help in predicting the next big threat, such as cybersecurity. Regardless of age or experience, no one person knows everything, and we should all strive to continually expound upon our knowledge of risks.

Good Example: "I have heard that unethical practices within the mortgage industry were a primary cause of the 2008 recession. I am working on a mortgage insurer that is rolling out a new pricing engine; what are the primary risks?"
Bad Example: "There were no issues noted during the prior examination and management says there has been no significant changes, so examiners noted no significant risks."

Major Examination Documents

Continuing the theme of previous sections – When it comes to significant exam documents such as the Examination Planning Memorandum, Summary Review Memorandum ("SRM"), and Report on Examination ("ROE"), the exam team should start working on these documents as early as possible. A large amount of the information and conclusions drawn during Phase 1 feed these documents. From an efficiency perspective, we have found it is much easier to hack away at these documents as the information is obtained rather than let the mole hills turn into mountains as they near their respective deadlines. Much like prospective risk testing, the drafts of the SRM and ROE can be used as productive fillers while waiting on information requests in Phases 3 and 5. In addition, writing these reports as the exam goes on has helped me avoid a common blunder: forgetfulness. When the all-too-common occurrence of a misplaced notepad pops up, having your preliminary thoughts and conclusions in a draft document can be a lifesaver!

Good Example: Transforming a Phase 1 conclusion write-up into a constructive background paragraph for the ROE early in the examination.
Bad Example: Waiting until all risks have been carried through their respective matrices before starting the ROE.

Closing

In summary, there are a number of strategies and best practices to better help examiners keep up with the ever-changing regulatory landscape while maintaining high levels of efficiency. With the NAIC continually fine-tuning examination procedures and standards, examiners can implement these best practices to streamline their work while ensuring the most significant risks are investigated thoroughly. We hope you can apply some of these tools into your everyday tasks. Just remember; if everything seems to be going a little too well and you think you may be on the verge of the perfect exam, you might want to pinch yourself!

About the Authors

***Alex Pirie*, CFE, CPA, CMA, CIA, CFE (Fraud)**, provides life, health and P&C consulting and financial examination support on behalf of state insurance departments. Since joining RRC, Alex's main focus has been risk-focused examinations for companies of various sizes and characteristics (which includes thorough examination of company's materials and background, and documenting processes and testing results). Alex graduated from the University of Georgia with a Bachelors of Business Administration in both Accounting and Finance, as well as a Masters in Accounting. Alex is a CFE, CPA, CMA, CIA, CFE (Fraud).

***Conor Scannell,* AFE**, participates in risk-focused examinations on behalf of state insurance departments, ensuring they are keeping pace with the changing regulatory environment. Conor's role also involves providing targeted, up-to-date advice to his regulatory clients. Since joining RRC, Conor has worked on numerous financial examinations, including coordinated examinations of large, complex, multi-state insurance companies. Conor graduated from Salisbury University with a Bachelor of Science in Finance and an Accounting Minor.

NAIC 2020 Spring Meeting Highlights and NAIC Interim SAPWG Adoptions- Relief is Here!

By Lauren Williams, CPA and Joanne Smith, CFE, MCM
Johnson Lambert LLP

NAIC 2020 Spring Meeting Highlights Published March 31, 2020

Originally scheduled to be held in Phoenix, AZ, the NAIC announced on March 11th its Spring National Meeting would be held virtually due to the COVID-19 pandemic. As a result, the agenda was transformed into a series of Public and Regulator-only conference calls throughout March and April. However, circumstances rapidly changed, and on March 24th, the NAIC announced it would suspend holding the sessions and released the following:

"The NAIC officers have decided, effective immediately, to suspend holding any further sessions of the virtual Spring National Meeting to allow our members and staff more time to focus on this health emergency. This change enables state insurance regulators to better focus on the health and safety of insurance consumers and the impact this pandemic is having on the insurance market."

Johnson Lambert LLP is committed to monitoring the NAIC's activities, and will provide periodic updates on key NAIC activities. Below, is a summary of the Statutory Accounting Principles Working Group (SAPWG) adoptions and actions in March and highlights from the COVID-19 symposium and how state insurance departments are responding nationwide.

Statutory Accounting Updates

Ref #	SSAP #	Title	Revision Description	Effective
2018-26	5R, 97	SCA Loss Tracking – Accounting Guidance	Clarifies that reported equity losses of a subsidiary, controlled or affiliated (SCA) entity stop at zero, and if a financial guarantee or commitment is present, the guaranteed liabilities are reported under the provisions of SSAP No. 5R.	03.18.2020
2018-38	55	Prepayment to Service and Claims Adjusting Providers	Clarifies that loss adjustment expense liabilities must be recorded regardless of prepayments to third parties, except for capitated health claim payments.	03.18.2020
2019-08	51R, 52	Reporting Deposit Type Contracts	Adds a footnote to Exhibit 5 – Life Contracts to disclose circumstances when mortality risk is no longer present or a significant factor.	03.18.2020
2019-32	97	Look-Through with Multiple Holding Companies	Individual audited SCAs may be admitted by "looking through" multiple downstream non-insurance holding companies provided each look-through entity complies with SSAP No 97.	03.18.2020
2019-33	25	SSAP No. 25 Disclosures	Requires aggregation and disclosure of similar related-party transactions, that on a stand-alone basis are not material, but could be material when aggregated.	03.18.2020
2019-35	51R, 56, 61R	Update Withdrawal Disclosures	Minor revisions to previously adopted liquidity disclosures for life, health and separate account guaranteed products for consistency with Blanks Working Group adoptions.	03.18.2020
2019-40	53	Reporting of Installment Fees and Expenses	Installment fee revenue guidance should be narrowly applied and not analogized to other fees or service charges to exclude them from being reported as premium.	03.18.2020

Statutory Accounting Updates				
Ref #	**SSAP #**	**Title**	**Revision Description**	**Effective**
2019-48	62R	Disclosure Update for Reciprocal Jurisdiction Reinsurers	Revision to incorporate disclosure updates for reinsurers from reciprocal jurisdictions into SSAP No 62R in line with the "Bilateral Agreement Between the United States of America and the European Union on Prudential Measures Regarding Insurance and Reinsurance" and the "Bilateral Agreement Between the United States of America and the United Kingdom Regarding Insurance and Reinsurance."	03.18.2020

Interpretations Exposed with Shortened Comment Periods

On March 26th the SAPWG exposed the following interpretations with a brief public comment period ending April 2, 2020:

- INT 20-01 ASU 2020-04 - Reference Rate Reform - Adopts FASB guidance for transitioning from LIBOR, except for debt securities classified as held-to-maturity which is not a statutory concept
- INT 20-02 Extension of Ninety-Day Rule for the Impact of COVID-19 – Insurers may delay non-admitting premiums receivable and amounts due for high deductible policies until September 28, 2020
- INT 20-03 – Troubled Debt Restructuring Due to COVID-19 – In determining whether a mortgage loan modification is considered troubled debt restructuring, insurers should refer to a Federal and state banking regulator joint statement on their approach to accounting for loan modifications in response to COVID-19
- INT 20-04 – Mortgage Loan Impairment Assessment Due to COVID-19 – Insurers may delay impairment assessments of mortgage loans and investments which predominately hold underlying mortgage loans until September 28, 2020

Rejected ASUs

The following FASB ASUs were rejected by the SAPWG during the meeting:

- ASU 2013-11, Income Taxes: Presentation of Unrecognized Tax Benefit When a Net Operating Loss Carryforward, a Similar Tax Loss, or a Tax Credit Carryforward Exists
- ASU 2016-14, Not-for-Profit Entities: Presentation of Financial Statements of Not-For-Profit Entities
- ASU 2017-11, Earnings Per Share; Distinguishing Liabilities from Equity; Derivatives and Hedging: (Part I) Accounting for Certain Financial Instruments with Down Round Features, (Part II) Replacement of the Indefinite Deferral for Mandatorily Redeemable Financial Instruments of Certain Nonpublic Entities and Certain Mandatorily Redeemable Non-controlling Interests with a Scope Exception

Virtual NAIC COVID-19 Symposium

The NAIC conducted a virtual forum via video conference to discuss the nationwide State Insurance Department response to the COVID-19 pandemic. Director Ray Farmer, NAIC President, emphasized the NAIC is focused on efforts "to protect the public, to share factual information, to facilitate access to testing and treatment, and to ensure the safety and solvency of our insurance sector."

The Insurance Information Institute (III) provided a financial impact analysis. Participants were reminded to continue planning and preparing for future catastrophes, and that the state guaranty system will cover the unlikely event of insurer insolvency. The following are anticipated within the P&C industry:

- Workers' Compensation may be the highest impacted line of business, with increased exposure for hospital, medical, law enforcement, first responders, transportation and retail employees. Clarity will be needed when the source of infection arises from work, and situations where employees work remotely but the employer does not control the work environment.
- Liability coverage may be moderately impacted by failure to adequately follow and communicate public health guidance. Clarity is needed regarding protective equipment and sanitizers.
- Director and Officer coverage may be moderately impacted in regards to financial statement disclosures.
- Property and auto coverage is expected to be the least impacted as there is a reduction in the movement of goods and services. Claim volume will likely decrease, countered by concerns for scarcity pricing for parts or repairs.
- Business Interruption coverage was deemed to be the lowest impacted due to policy terms that:
    - Include long waiting periods
    - Have high deductibles
    - Have stipulations for direct property loss
    - Exempt losses due to infectious disease
- Event cancellation and travel insurance policies typically have contagious disease exclusions and will experience low impact.
- Cyber risk is expected to increase due to the number of employees working from home.

A key component of the Symposium was a discussion from leadership in the Health, Life, and P&C insurance industry, led by the CEOs of American Council of Life Insurers (ACLI), America's Health Insurance Plans (AHIP), and American Property Casualty Insurance Association (APCIA). The associations were joined by an NAIC Consumer Representative & Senior Policy Analyst, Center on Budget and Policy Priorities to advocate for the concerns of consumers.

Life Insurance Industry is focused on paying life insurance claims timely and providing access to annuity products for retirees and long-term savers. Life insurers are avoiding service disruptions by staffing call centers, allowing e-signatures and underwriting insurance products without medical visits. Recommendations to regulators included: considering insurance as an essential service during shelter-in-place orders, considering reducing rate and form filings, and considering uniformity and coordination between states on COVID-19 preparedness questionnaires.

Health and Managed Care Industry is focused on eliminating out-of-pocket costs for COVID-19 testing and treatment, increasing telehealth access and coverage, faster pharmacy prescription refills, increasing medical network capacity, providing transportation to medical appointments, and ensuring providers and hospitals have medical equipment and supplies. Recommendations to regulators included greater communication between state regulators and collaboration with health carriers when operational mandates are considered to ensure quick implementation, and balancing the need for regulatory oversight with the health insurer's need to devote time and resources to members, enrollees, clinicians and employees.

Property & Casualty Industry requested regulators consider uniformity and consistency when premium grace periods are requested and allowing insurers report account receivables similar to late payments of premiums receivable during natural disasters. Recommendations included caution to regulators to avoid requiring retroactive coverage for claims that were never underwritten, which could have negative impacts.

NAIC Consumer Representative requested regulators consider measures to: maximize access to health coverage, eliminate the financial strain that prevents people from complying with social distancing, ensuring access to health treatments with protection from surprise medical bills and out-of-pocket costs, protect consumers from fraud and scams, implementing delays on auto insurance premium payments, and a moratorium on credit scoring for underwriting.

Director Farmer adjourned the public portion of the Symposium with an uplifting message that the NAIC will search for innovative solutions and will continue protect consumers and the stability of the insurance industry.

The NAIC released recordings of the COVID-19 Public Special Session and a variety of insurance industry resources and updates at https://content.naic.org/naic_coronavirus_info.htm.

NAIC Interim SAPWG Adoptions – Relief is Here! Published April 21, 2020

Johnson Lambert LLP is dedicated to keeping you informed of changes adopted by the NAIC Statutory Accounting Principles (E) Working Group (SAPWG) that will impact your statutory basis financial statements. The following updates were adopted April 15, 2020 in an interim session of the SAPWG and specifically relate to reference rate reform and temporary accounting relief for insurers due to the COVID-19 pandemic. These adoptions generally resemble the GAAP guidance on which they are modeled.

Statutory Accounting Updates

Ref #	SSAP #	Title	Revision Description	Effective
2020-12, 20-01T	15, 22R, 86	Reference Rate Reform	Reporting entities may have entered into contracts with interest (LIBOR) rates referring to London Interbank Offered Rate and other interbank offered rates (IBORs) such as surplus notes, lines of credit, premiums financing and derivative contracts. This INT adopts ASU 2020-04, with modification, to permit optional, transitional and expedient guidance resulting from financial institutions moving away from LIBOR and other IBORs. A change in rates generally requires re-measurement of the contract, or in the case of a hedging relationship, a de-designation of the transaction. The revisions permit reporting entities to account for a reference rate change as a continuation of a contract or hedging relationship through December 31, 2022.	04.15.2020
20-02T	6, 47, 51, 65	Extension of Ninety-Day Rule for the Impact of COVID-19	Temporary extension of the 90-day admissibility rule for policies in effect and current prior to March 13, 2020 and policies written or renewed on or after March 13 due to the COVID-19 pandemic. Includes premiums receivable from policyholders or agents, uncollected uninsured plan receivables, life premium due and high deductible receivables. Relief is provided for the first and second quarter filings in 2020 and allow these assets to be admitted even if they are greater than 90 days past due. Existing impairment analysis remains in effect for these affected policies.	04.15.2020
20-03T	36	Troubled Debt Restructuring Due to COVID-19	Temporary accounting relief to permit insignificant mortgage loan and bank loan modifications due to COVID-19 to not be accounted for as a troubled debt restructuring, including: • forbearance arrangements, • interest rate modifications, • repayment plans and other similar arrangement that defers or delays payment of principal or interest for loans that were not more than 30 days past due at December 31, 2019. This treatment is consistent with the provisions in the April 7, 2020 "Revised Interagency Statement on Loan Modifications by Financial Institutions Working with Customers Affected by the Coronavirus".	04.15.2020

Statutory Accounting Updates				
Ref #	**SSAP #**	**Title**	**Revision Description**	**Effective**
20-04T	26R, 30, 37, 43R, 48	Mortgage Loan Impairment Assessment Due to COVID-19	Temporary accounting relief permitting the deferral of impairment assessments for mortgage loans, bank loans and investments that predominantly hold underlying mortgage loans such as a mutual fund, for the first and second quarter filings in 2020.	04.15.2020

The NAIC elected a wait-and-see approach to determine if an extension of the accounting relief under the three COVID-19 related interpretations is necessary.

Johnson Lambert LLP Disclaimer: *This communication is intended to provide general information on COVID-19-related measures as of the date of this communication and may reference information from reputable sources. Although our firm has made every reasonable effort to ensure that the information provided is accurate, we make no warranties, expressed or implied, on the information provided. As COVID-19-related efforts are still ongoing, we expect that there may be additional guidance and clarification from regulators that may modify some of the provisions in this communication. Some of those modifications may be significant. As such, be aware that this is not a comprehensive analysis of the subject matter covered and is not intended to provide specific recommendations to you or your business with respect to the matters addressed.*

SOFE Editor's Note: *This article was originally published by Johnson Lambert LLP on its website in two parts on March 31, 2020 and April 21, 2020. For the original versions of the article, please visit https://www.johnsonlambert.com/post/naic-2020-spring-meeting/ and https://www.johnsonlambert.com/post/naic-interim-sapwg-adoptions-relief-is-here. Reprinted with permission.*

About the Authors

***Lauren Williams*, CPA**, is a Partner with Johnson Lambert, a multi-office, niche-focused firm that provides audit, tax, and consulting services to insurance entities as well as nonprofits and employee benefit plans. With more than a decade of experience, she specializes in providing attest services, primarily to property-casualty insurers with a sub-specialty in the medical professional liability space, related service entities, risk retention groups, and governmental risk pools. Lauren is a member of the firm's Technical Committee. Lauren is actively involved in the industry and she attends NAIC meetings on behalf of Johnson Lambert. Additionally she represents the firm on the NAIC/AICPA Task Force. She is a frequent author and speaker on insurance-focused technical topics. Lauren can be contacted at LWilliams@JohnsonLambert.com.

***Joanne Smith*, CFE, MCM** is a Senior Manager in Johnson Lambert's national Regulatory Services Practice. She has over 10 years of experience conducting and coordinating statutory financial examinations, market conduct examination and other special projects on behalf of state insurance departments utilizing the risk-focused method with an emphasis on internal controls and corporate governance. She has served in the roles of Lead State Examiner-In-Charge, Facilitating State Examiner-In-Charge, and/or Participating State Examiner-In-Charge on several multistate coordinated financial examinations of insurance company groups. Joanne is a Certified Financial Examiner (CFE) and has obtained the Market Conduct Management (MCM) certification. Joanne is a member of SOFE and has served on the SOFE Board of Governors since 2016, and the SOFE Executive Committee since 2018. She has been actively involved in the Publications Committee since 2010, and currently serves as the Chair of the SOFE Publications Committee. Joanne can be contacted at JSmith@JohnsonLambert.com.

Insurance Collaboration is a Captivating Idea

By Stephen R. DiCenso, FCAS, MAAA
Milliman

As I write this article, we are in the midst of an unprecedented time for all of us, characterized by widespread social distancing and working from home caused by the COVID-19 pandemic. This situation has affected personal health and safety, and continues to have a devastating economic impact across much of the globe.

I live in the insurance capital of the world, Hartford, Connecticut. I've been an actuary employed in the property and casualty (P&C) insurance industry for over 30 years now, having been employed by four insurers. I currently work in a consulting capacity with the global firm Milliman. I am also the current president of the Connecticut Captive Insurance Association (CCIA). My career focus has largely been in the commercial lines.

I have read numerous articles about the pandemic, focusing on the impact of the virus to our citizens, how our society has responded to them, and then more specifically on my area of expertise, P&C insurance. As I look at all of the P&C insurance issues that have been discussed since the onset of the virus, it is becoming ever more apparent to me that the P&C insurance industry would benefit from more direct collaboration and communication with its customers. As a result, it would improve customers' understanding of how their risks are managed and mitigated, leading to a successful insurance marketplace and enhanced public support for the industry.

We all want insurance markets to succeed; insurance is a critical function supporting our economy. This means that, in exchange for the transfer of all or most of a customer's risk to an insurer at a fair market price, the insurer is positioned to make a reasonable return on equity across all of its customers. In doing so, the insurance industry demonstrates leadership and takes actions that improve the lives of the people it employs and the customers and communities it serves.

Let's recognize that the insurance industry is justifiably not able to provide a complete insurance solution in all situations. In particular, this very reality spawned the captive insurance industry. We also know that, in recent years, we have seen the rise of the insurtech movement due to opportunities within the industry. As a result, agents and brokers, who are also key constituents in this ecosystem, are adjusting their business models. All of these elements working together will continue to help provide full and efficient insurance solutions for customers.

However, the onset of the COVID-19 pandemic has once again revealed a fundamental issue that needs more attention from the traditional insurance industry—that insurance buyers often believe they have adequate insurance coverage when they actually do not. This leads to widespread dissatisfaction with the insurance solutions currently available to them. As a result, I believe we need to think even harder about working more collaboratively across these three insurance sectors with a holistic focus on customer satisfaction.

The insurance industry was never meant to cover all losses from a pandemic. Insurance is all about the law of large numbers—many insureds pay a premium so that insurance can be affordable for the few who ultimately need it. In the case of COVID-19, there are segments of our economy where this principle has been largely invalidated (e.g., restaurants, nonessential small businesses, household contractors, many gig workers, etc.); these businesses are virtually completely shut down and many insureds are looking for business interruption (lost income) coverage under their commercial property policies. The traditional insurance market is not meant to handle a situation where all insureds are making claims at once, and thankfully, our federal government has stepped in to provide temporary financial support.

On the other hand, much of the industry can do better. For example, the indemnification process for large, adverse events is often very inefficient for its affected policyholders and claimants. With COVID-19, variations in policy language for business interruption coverage[1] will lead to significant amounts of costly litigation, leaving businesses with a suboptimal insurance experience. COVID-19 is certainly a unique situation, but viruses in general are not new, and some insurance forms specifically address their impact. To its credit, the industry does support a new government fund to help businesses and workers hurt by COVID-19 shutdowns,[2] and there are numerous companies refunding premium to policyholders who have reduced exposure to risk.[3]

Looking back, the industry has done a lot to manage catastrophe risk in general. For most traditional catastrophic perils, such as hurricane, tornado, earthquake, and flood, insurers have continued to improve upon models to assist them with underwriting and pricing. They realize they cannot fully fund this exposure in the private insurance market, so they collaborate with the reinsurance market and, more recently, with the capital markets (via insurance-linked securities). Insurance for terrorist events was made available due to the industry's vision in recognizing that a federal backstop was needed for the product to function. While I believe there is a lot more that can be done to enhance public-private insurance partnerships, each of these efforts has been a step in the right direction. However, at the same time, the industry has not always been quick enough to adopt newer forms of insurance (e.g., parametric insurance, which can provide widespread insurance based on the trigger of a certain-sized catastrophic event). And for COVID-19, might better public-private coordination with government have facilitated a liquidity solution such that the industry could make very quick and needed payments to its insureds, and then seek government reimbursement?

Another vexing insurance coverage inefficiency that will arise with COVID-19 is related to certain workers. Many workers deemed "essential," who have exposed themselves to the virus (e.g., grocery store clerks), will have a very onerous standard[4] to prove that COVID-19 is a compensable occupational disease under workers' compensation state laws. I appreciate that our industry policies are a contract of adhesion—the insurer has more power. But while these workers and their employers will act in the interest of social good, it does not

seem fair that they may not get compensated for lost wages if they miss work due to contracting the virus. We can debate or litigate whether these workers intentionally exposed themselves to this ("intentional acts" are not covered by insurance), or we could instead provide an efficient solution (e.g., likely a combined public-private government-backed plan). This resulting lack of customer understanding and satisfaction demonstrates that the industry is providing these businesses with a suboptimal solution. Policyholders don't always know what they are buying, and operating under a "buyer beware" mentality is likely not the best message for the industry to be sending at this time. Let's recall that workers' compensation was set up to be a no-fault coverage—where the worker gives up the right to sue the employer in exchange for wage replacement benefits and reimbursement of medical costs. But the likely amount of litigation, focused on whether a claim is compensable ("arose out of and in the course of employment") will be both staggering and fraught with delays as the court system deals with increasing backlogs given that they too have been shut down. This is detrimental to our industry's reputation.

There are many other situations outside the COVID-19 pandemic where P&C coverage did not respond in the manner the consumer expected it would, again resulting in costly litigation. The wind versus flood debate with Hurricane Sandy. The questions of whether 9/11 was one occurrence or multiple occurrences and when coverage is triggered in liability policies. While we come to expect litigation, there's no reason this situation cannot improve.

Another newer market segment that seems to be following a somewhat similar path is cyber. To this point, insurers have dipped their toes into the cyber insurance water by offering very limited amounts of coverage to lots of customers. They've done a great job for their shareholders by making lots of profit on it to date. And some insurers have done a very good job in helping to mitigate this risk for their insureds through training and proactive claims resolution. But if a truly large cyber event hits, what will the perception be of the industry when so many customers will not be sufficiently compensated because the industry has not done enough to create a backstop? And what if they then restrict coverage, as typically happens in such cases?

I know that there are other ways to transfer risk if the traditional insurance industry does not do it efficiently. The proliferation of captive insurance companies in the last 35 years suggests that commercial insureds are ready to take on their own insurance risks when insurers either don't want to at any price or won't offer coverage terms at a reasonable cost. Captives can be more flexible forms of self-insurance and risk pooling that incentivize the insureds to actively manage their own risks and reduce costs. In addition, very large entities like Amazon have discussed offering insurance directly to customers. And the insurtech movement looks to help change the entire insurance-buying experience (e.g., Lemonade, a New York-based insurer of homeowners and renters, which donates a portion of its profits to charity if no claims are filed). In essence, noninsurance companies have recognized the opportunity to service the insurance market.

Let's be clear that the "traditional" insurance industry is not alone in struggling with providing satisfactory solutions to the market. Tech giants Uber and Lyft have had significant difficulty finding how best to structure their insurance offerings to drivers, both from the standpoint of the driver's liability to others, and for the driver's own protection. Amazon is still developing its insurance offering. And you may have heard that certain types of small captives (known as an "enterprise risk captive," or ones that make the 831[b] election for tax purposes) are under significant scrutiny by the Internal Revenue Service (IRS) for the rates being utilized.

Traditional insurers, however, also face additional challenges from many other fronts—climate change, social inflation, legislative changes (e.g., extensions of statutes of limitations on sexual abuse cases, continuing mass torts, etc.). And the world is so much more transparent these days—questionable actions cause immediate and forceful customer reactions that can easily cause severe reputational risk.

Thus, in order to achieve a desired level of success going forward, I think insurers will need to work more seamlessly with their customers. Insurers will need to continue to work collaboratively with all parts of the insurance ecosystem to ensure consumers are better educated, treated fairly, and adequately protected.

Here are a few other ideas to get us thinking along these lines of collaboration:

- Gather insurtech providers, insurers, and corporate insureds together to discuss how captives can be used to incentivize the quicker adoption of cost-reducing technologies.
- Gather the above parties and regulators to discuss areas where parametric insurance can bring a cleaner solution to potential large-scale, interconnected risks (e.g., climate change, cyber, etc.).
- Allow insurtechs to leverage artificial intelligence (AI) and machine learning technologies to filter through insurers' policy coverage forms to quickly identify areas of coverage gaps.
- Educate auditors, who are already in a key position as trusted business advisors, to be more conversant in these various insurance issues and mechanisms to improve customer understanding of insurance.

I believe insurers should work more to provide customers a complete risk mitigation solution; not one that leaves customers less than fully reimbursed and/or facing a road of litigation. The more I see, the more it seems to me that greater collaboration and the pursuit of innovative tools in managing customer risks will be the key to a successful insurance marketplace, and also enhance public support for the industry.

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About the Author

Stephen DiCenso, **FCAS, MAAA**, is a Principal with the Boston office of Milliman. He joined the firm in 2008. Steve has enjoyed a multifaceted property and casualty actuarial career, with most of his experience in the commercial alternative markets. With Milliman, he has focused on serving captives, large self-insured corporations, mid-sized insurers, runoff insurers, public entity risk pools, and state regulators. This includes reserving, pricing, surplus management, cost allocation, risk-focused financial examination work, due diligence, financial modeling, and risk financing. He also consulted for seven years with a major accounting firm, and his insurance company experience includes chief actuary positions at an alternative markets insurer and a third-party administrator owned by a major insurer, as well as senior management experience with a property and casualty programs insurer and a fidelity and surety bond insurer. Contact Steve DiCenso at stephen.dicenso@milliman.com.

Risks in Pricing Life, Health and Property & Casualty Insurance Products

By Stephanie Crownhart, FSA, MAAA
Katie Koch, FCAS, MAAA
Andrea Huckaba Rome, FSA, MAAA
Adrianne Talbert, ASA, MAAA
Lewis & Ellis, Inc.

At the SOFE July 2020 Career Development Seminar, actuaries from Lewis & Ellis, Inc., who represent all facets of insurance: life, heath and property and casualty, virtually presented a session titled Risks in Pricing Life, Health and Property & Casualty Insurance Products.

Within this session, we discussed the universal risks in pricing various insurance products and how companies go about pricing a product for the market. Emphasis was placed on how pricing risk is a prospective risk that may impact the financial condition of an insurance entity. We used the risk focused financial examination Phases and excerpts from the official 2020 NAIC Financial Conditions Examiners Handbook (FCEH) as a reference.

During Phase 1 financial examiners specifically consider prospective risks for indications of solvency concerns. FCEH states that "in addition to assessing business risks, other elements that would commonly be assessed for prospective solvency risks include consideration of the company's…pricing and underwriting… Among other things, these assessments should include consideration of the company's rate of growth and whether the liquidity of assets would create future concerns about the company's financial solvency."

From an actuarial perspective, there are some common pricing themes between life, health and property and casualty pricing. Generally speaking, all three areas strive to utilize historical claim and expense experience to project the future when practical; we all rely on actuarial assumptions and actuarial methods explored during the actuarial examination credentialing process. We also understand that many insurance product offerings operate in competitive markets. There are risks of adverse selection, risks of a product growing too fast or too slow, and risks of not properly matching the rate to the individual risk.

While having their similarities, these three areas also have very diverse considerations. There are key assumptions, issues and considerations facing these insurance markets today. These are all areas that should be given some thought in your next risk focused financial examination.

Actuaries with expertise in the various subject matter areas can offer meaningful value in navigating pricing risk through various phases of the risk matrix. Your actuarial specialist can assist with any or all of the following:

- Questions to ask in C-Level interviews regarding pricing and under writing practices
- Evaluations of Inherent Risk
- Identifying needed evidence documentation to request
- Qualitative review of pricing and underwriting control evidence
- Identifying whether moderate or high residual risk remains
- Recommending/Designing Phase 5 testing procedures
- Implementing Phase 5 testing procedures

Life Insurance Perspective

Life insurance provides relief from financial hardship or loss in the event of the insured person's death, and is offered under various chassis, including: whole life, term life and universal life. Annuities are also included under the life insurance umbrella providing a savings vessel and income during the retirement years.

Due to the long-term nature of common life insurance products, if pricing assumptions deviate materially from actual experience, the company could be exposed to risks for many years that may be difficult to mitigate. The key assumptions that drive life insurance profit and premium include mortality, policyholder behavior, expenses and the economic environment. Figure 1 provides additional detail for these pricing assumptions.
In order to assess the pricing risk during the examination process, key considerations include:

Life Pricing Assumptions

- Mortality - both pricing mortality and reserving mortality
- Policyholder Behavior - Lapses, Surrenders, Other benefit utilization
- Expenses - Underwriting costs, Compensation structures, Maintenance costs
- Economic Environment - Earned interest rates

Figure 1

- Does the entity have a detailed, documented pricing peer review process?
- What role does sensitivity testing play in pricing?
- If the company performs cash flow testing to assess asset adequacy – can the company sustain moderately adverse deviations in assumptions?
- Does the entity perform regular experience studies and monitor actual to expected results?
- What level of communication occurs between underwriting and actuarial?
- How has the company's underwriting practices evolved over time and how have changes been implemented in pricing?

Based on the above considerations, Phase 3 may involve the review of a company's risk mitigation controls and documentation regarding pricing peer reviews, sensitivity testing, experience studies and underwriting practices.

One important item to consider when reviewing a company's prospective pricing risk is the impact of a company's underwriting practices on the mortality assumed. Throughout the years, underwriting practices have evolved from differentiating by gender only to current practices which include nonsmoker/smoker breakouts with multiple "preferred" risk categories. In addition to the changing landscape in risk class definitions, more recent hot

topics involve changes to underwriting methodology which impact mortality. More specifically, Accelerated Underwriting (AUW) is becoming much more common place. The goal of AUW is to maintain similar pricing as traditional underwriting with fewer resources needed and thus eliminating the need for more invasive medical exams. The ever-evolving underwriting practices can present some challenges when companies attempt to aggregate and examine their historical experience in a mortality study. Collective industry data and the Society of Actuaries "Risk Tool" are resources to help companies get a handle on the impact their underwriting procedures might have on pricing assumptions.

Along those lines, a common obstacle faced by life insurers is the lack of credible historical experience as a result of:

- A new product or benefit feature offered by the company in which they have no internal experience to examine. Or the product is novel to the industry, and there is not any industry experience available.
- New underwriting approaches. Given the long-term nature of these products the full impact of new approaches will not be realized for a while.
- Small insurance companies by nature have a lack of credible historical experience to base pricing assumptions on.

Pricing actuaries tend to supplement less than credible internal historical mortality experience with outside experience to the extent it is available. Sources of this outside experience could come from reinsurers or the Society of Actuaries.

Specific phase 5 testing that can be completed by the examining actuary include the review of a company's experience studies – both the approach the company takes in reviewing their experience as well as the actual results produced by the studies. Reviewing how the actual results compare to expected assumptions utilized in pricing would provide insight into the underwriting results. For those companies entering into accelerated underwriting programs, scrutiny in the examination process may be appropriate in order to assess that they are properly monitoring the results of their underwriting program. This would involve reviewing any documentation on their review process and any statistical analysis conducted to assess the results of the experience study.

Another relevant industry trend to consider in your next risk focused financial examination is the impact of a sustained low interest rate environment. Many older Universal Life and Annuity plans were priced with high guaranteed returns to the policyholder. Maintaining those guarantees in the current environment can be a strain. Furthermore, many older products were priced assuming a much higher portfolio yield would be earned on income. During the examination, a review of the Actuarial Memorandum supporting the Actuarial Opinion can provide insight into the adequacy of older pricing and can be a great source for understanding a life insurer's risks, if documented appropriately.

As we have seen over the last few months, an unexpected event, like COVID-19, can cause widespread disruption in many areas of our life. The "Pandemic" scenario should consider the accumulated impact of extreme low interest rates, high unemployment (leading to higher lapses) and the spike in mortality. Some life insurance companies have re-run their pricing models and cash flow testing models in order to assess the impact of this event. The culmination of each of these stresses should be reviewed and considered when assessing a company's ability to withstand stressed scenarios. A deep dive of a company's sensitivity testing both in pricing and asset adequacy should provide insight into how the Company monitors risk.

Health Insurance Perspective

Health Insurance refers to a broad suite of products including Comprehensive Major Medical (CMM), Disability, Critical Illness, Indemnity Coverage, Dental, Vision, Long Term Care (LTC) and Public Health Coverage like Medicare and Medicaid. The thread that runs throughout these coverages is that they are short-term liabilities (except for LTC), that help a member to pay for medical costs.

Health coverages are often different from Life and P&C insurance in that it is more likely that covered services are anticipated or planned. (Think about routine care for Dental coverage, or elective surgeries under a CMM plan, or risk of regular care due to a chronic condition.) Some Health coverages are also unique in that lack of health coverage does not preclude medical treatment. Rather, treatment still occurs but the financial burden is shifted to society. Thus, when considering medical coverage pricing, it should be viewed not only as a function of the company's financial stability, but also the impact to the entire market.

The goal of a financial examiner and actuarial partners is to determine if the pricing adequately accounts for the applicable risks. The focus should be on verifying that the company has adequately considered their own financial stability, but also provide coverages that are fair and serve to maintain a stable market. When reviewing pricing risk for Health Insurance, the examination team should consider the following highlighted risks, among others.

Regulatory Risk
Because Health Insurance intersects with public health on many fronts, it is regularly being scrutinized and laws are often changed, at the state and federal level. For example, CMM coverage is regularly changing due to the influence of the Patient Protection and Affordable Care Act (PPACA). Over the years, there have been court challenges, changes to taxes and fees, changing risk balancing programs, changes to requirements for purchasing coverage… the list goes on. Other coverages are not immune to the constant changes either; Medicare and Medicaid are regularly altered due to new regulation,

and Long-Term Care is under constant scrutiny for writing long-term liabilities in an uncertain medical cost environment.

Each of these changes impacts how this coverage is priced. A change in a purchasing mandate could impact the demographics of your membership, and subsequently the expected claims you should anticipate. A change in required fees impact the overall cost of coverage. There have been instances where health insurance carriers have been required to submit multiple filings to regulators, depending on the outcome of pending legislation or a pending court ruling.

It is important that financial examiners be aware of these ongoing changes. Further, it is important, during all phases of the examination, to identify ways in which the company has adapted to these changes. Have they shown that they are aware and responsive? Or do the changes continue to catch them off guard? Do they have a process for sharing and incorporating new regulation into their pricing?

Credit Risk

Health insurance regularly works closely with healthcare providers, Pharmacy benefits managers, information systems vendors, reinsurance and stop-loss providers, and other third-party vendors of all sizes. Credit risk is the risk that these partners will not hold up their end of the deal; financial or otherwise. Some specific instances may include provider risk-sharing arrangements, where the insurance company and hospital, for example, share losses and gains. What is the likelihood, in this arrangement, that the hospital would not be able to absorb their share of losses and the company must take on the whole loss? Was this considered in pricing?

Another instance, with stop loss coverage or reinsurance, is considering the likelihood of receiving payment for claims that exceed the contractual threshold. More probable, is there a likelihood of delay in these payments that could impact the financials?

Has the company verified that their third-party wellness vendor is appropriately protecting personal health information of the members?

In all interactions with vendors and third parties, it is important that the company have controls in place for financial risk-sharing, data transfers, and all instances where the third-party actions could have an impact on the company. Further, if these risks have been considered and are likely, have they been included in pricing?

Trend Risk
One of the key risks when pricing health coverage, is projecting the likelihood of illness, and the cost of a claim. Likelihood of illness is often a lopsided equation where the member knows much more about their own health than the company writing the policy. Costs in health care change quickly based on negotiated contracts with providers, new innovations, and changes in utilization of services.

Setting appropriate trends is one of the key considerations in a successful pricing. The Financial examination team should discuss with the company how their trend-setting process works. Is there evidence of a thoughtful process that considers all variables without overreacting? Are the trends being used in line with the rest of the industry? Does the company have a history of over or under-predicting trend?

Selection Risk
As previously mentioned, not all healthcare claims stem from unexpected misfortune. This is not to say that unfortunate diagnoses and tragic accidents do not occur to otherwise healthy people. But often, members have a good understanding of their own health and will purchase coverage according to their predicted needs. When pricing and developing rules around underwriting procedures, the company must demonstrate understanding of their own selection risk and have appropriate controls in place.

Sometimes, this manifests itself as rules for participation in group coverages, or limits on the range of plans available. But it may also lead to limitations on coverage. An example in ACA Individual markets, Platinum plans, which contain the richest benefits available through the exchange, have become rare because they were heavily selected against. Now, if a carrier does offer a Platinum plan, when their competitors are unwilling to do so, they will find their enrolled population very unhealthy compared to the rest of the market.

Does the company have controls in place to limit anti-selection? Are they aware of their risks?

Final Words
There are many risks when pricing health plans that are unanticipated. Some examples that have played out in recent years:

- Covid-19 pandemic
- Cancelled Risk Corridor payments in the ACA Market
- Expensive Hepatitis-C Drug

We do not expect companies to have a crystal ball. There will always be instances where health insurance did not anticipate a huge change in the industry when pricing. What financial examiners should expect is a thoughtful examination of risks, and the ability to financially weather a moderately adverse event. Do they have procedures and controls that allow them to react quickly, and price appropriately?

Property and Casualty Insurance Perspective

Property and Casualty Insurance encompasses a wide range of products covering a multitude of insurance lines of business. Personal lines include homeowners, farm owners, private passenger auto and umbrella. Commercial lines include commercial multiple peril, commercial auto, commercial general liability, medical professional liability, other professional liability, and workers' compensation. Property and casualty insurance also includes travel insurance, pet insurance, title insurance and cyber liability insurance.

Entities offering property and casualty insurance coverage may specialize in only one or a small number of these lines. Alternatively, they may offer products touching on numerous lines of business.

To answer the big question of whether or not pricing adequately accounts for the risks, the risk focused examination team must dig deeper into the following areas:

- Is the entity performing reasonable analysis to assess risk and rate need by state and line of business at regular intervals?
- Is management reasonably responsive to the rate needs indicated from analysis during the examination period?
- Is there a reasonable level of communication between claims, underwriting and actuarial?

During Phase 3, the following data requests may assist in assessing the adequacy of risk mitigation controls. Note, these requests could be scaled to a reasonable test size if examination resources are limited (i.e. select the entities' larger or more complex states and lines of business, products with recent growth or higher risk markets):

- History of rate changes by state and by line of business
- Actuarial Rate Indication analysis estimates (most recent or at various points during the financial examination period)

Actuarial rate indications are often performed by state and by line of business or product separately. The actuarial specialist on your team can provide assistance in finding numbers within analysis, gaining insights, addressing questions of materiality, and assessing the reasonability and reliability of the actuarial rate indication analysis.

Figure 2 identifies common actuarial assumptions and actuarial methods utilized across all property and casualty lines of business. While these may be common, there are certainly unique features of various products and lines of business.

Actuarial Assumptions

- Trend (i.e. Frequency, Severity, Exposure)
- Loss Development
- Loss Adjustment Expense Provisions
- Expense and Profit Provisions
- Catastrophic Loss Potential
- Large Loss Potential
- Premium Adjustments
- Reinsurance Considerations
- COVID Impact (NEW)

Actuarial Methods

- Loss Ratio Method
- Pure Premium Method

Figure 2

COVID-19 Considerations in Actuarial Rate Indications

- Impact on actuarial data in trend, loss development and expense provision analysis
- Defense costs
- Investment returns
- Reinsurance markets
- Pandemic Catastrophe models in ratemaking
- Claims not anticipated in coverage (exclude?)

Figure 3

Considerations from COVID 19 and the resulting economic impacts are contained in Figure 3. The impacts will vary by insurance entity and line of business. Recent events caused by the pandemic has the potential to cause disruption in the historical data actuaries use in future actuarial analysis of trend, loss development and expenses for Considerations from COVID 19 and the resulting economic impacts are contained in Figure 3. The impacts will vary by insurance entity and line of business. Recent events caused by the pandemic has the potential to cause disruption in the historical data actuaries use in future actuarial analysis of trend, loss development and expenses for some lines of business. If low or volatile investment returns are projected, this may put upward pressure on an entity's indicated profit provision or risk margin need, hence putting upward pressure on the rates; is this happening? Reinsurance markets disrupted by claims or capital losses from the pandemic and any economic fallout may result in higher premiums charged to primary insurers or questions of reinsurance capacity. To the extent the market deems it prudent, it is conceivable that pandemic catastrophe models may become more common for some property and casualty insurance lines to assist with pricing in the future.

Going back to the basics, Figure 4 contains two hypothetical scenarios where Phase 5 detail testing of pricing adequacy as a prospective risk seems potentially reasonable.

P&C Pricing Adequacy Scenarios

Entity ABC has an 80/20 Personal Lines/Commercial lines business mix; 50% of writings are private passenger auto. Entity writes in a small number of states. Higher rates of growth observed even though markets are considered competitive. Most recent private passenger auto actuarial rate indications in the largest state were an actuarial rate indication in excess of +20% and a +2% rate change as filed; the state department of insurance actuary flagged this filing and communicated concerns to the state's Chief Examiner.	Insurance entity XYZ writes exclusively medical professional liability coverage in a small geographic region of the US with slow but steady declines in premium volume during the examination period. "Reasonable surplus" levels as of most recent year-end (e.g. no RBC regulatory action levels triggered). Policy retention concerns noted in C-Level interviews. Premium deficiency reserve indicated. During the course of gathering Phase 3 evidence, observe double digit actuarial rate indications with small rate changes requested during the financial examination period.

Figure 4

Other areas related to pricing and underwriting in property and casualty insurance are identified in Figure 5. Regarding the increased use of "Big Data" and complex algorithms in risk classification, predictive modeling is intended to enhance pricing accuracy and reduce, although not eliminate, uncertainty in pricing estimates. If there is concern over pricing adequacy as a prospective risk by financial examiners, documentation should be requested to demonstrate how predictive modeling has impacted pricing accuracy and what controls are in place for model risk; your actuarial specialist would be a good resource for drafting this request and reviewing evidence. Companies should have this documentation reasonably available as part of ERM initiatives, and it is sometimes requested by state regulators performing rate filing reviews. Market Conduct examinations may be concerning themselves with whether or not the correct rate is being charged to consumers; financial examiners would be more focused on how the predictive models are impacting financial solvency considerations.

Premium Deficiency Reserves
• Schedule P Loss Ratios by line of business • Positive actuarial rate indications
High Deductible Workers' Compensation
• Adequacy of Collateral estimates • Increased uncertainty in pricing and reserving
Underwriting
• Big Data Analytics • Complex Algorithms

Figure 5

Pricing and Underwriting can be complex in insurance, and the dynamics are evolving. Financial examiners and their actuarial specialist(s) can work together to ensure responsible, risk focused financial examination work related to these prospective risks.

About the Authors

Stephanie Crownhart, **FSA, MAAA** is a Fellow in the Society of Actuaries and a Member of the American Academy of Actuaries. She has 10 years of **life insurance** experience. She received a Bachelor of Science degree in Actuarial Science and Mathematics from the University of Central Missouri. She began her career as a pricing actuary. She has experience in the areas of enterprise risk management, experience studies, policy form review, pricing and product development. Her recent experience includes statutory and GAAP actuarial audit work, financial examinations, asset adequacy analysis, valuation and financial reporting for life insurance. She has significant experience in the design and implementation of reinsurance agreements. Crownhart@LewisEllis.com

***Adrianne Talbert*, ASA, MAAA** is an Associate in the Society of Actuaries and a Member of the American Academy of Actuaries. She is a practicing **life actuary**. She graduated from Culver-Stockton College with a Bachelor of Science degree in Mathematics and from Columbia College with a Bachelor of Arts degree in Business Administration. She has 12 years of experience working for an insurance company. That position allowed her to develop skills across actuarial disciplines. Her areas of practice have included both life and P&C pricing and product development, statutory valuation for life and annuity products, cash flow testing, experience studies analysis, reinsurance system implementation, and actuarial software conversions. ATalbert@LewisEllis.com

***Andrea Huckaba Rome*, FSA, CERA, MAAA** is a Fellow of the Society of Actuaries, a Member of the American Academy of Actuaries and is Certification Enterprise Risk Analyst. She is a practicing **health actuary** with 10 years in the industry. She spent 5 years in the actuarial department of Blue Cross and Blue Shield of Kansas working on pricing, reserving and analysis for commercial products, and later, enterprise risk management implementation. Current responsibilities at Lewis & Ellis include pricing for self-insured trusts, individual and small group commercial market rate review for state insurance departments, and risk-based financial exams reviewing pricing and reserving risks.
AHuckabaRome@LewisEllis.com

***Katie Koch*, FCAS, MAAA** is a Fellow of the Casualty Actuarial Society and a Member of the American Academy of Actuaries. She is a practicing **property & casualty actuar**y with over 15 years of actuarial experience in valuations, reserving and pricing. This experience is comprised of time with two large multi-line property and casualty insurance carriers, a state insurance department and actuarial consulting. Katie provides actuarial services in conjunction with appointed actuary, auditing actuary and examination actuary assignments. Ms. Koch reviews and prepares actuarial and technical support and memorandums for state rate filings. KKoch@LewisEllis.com

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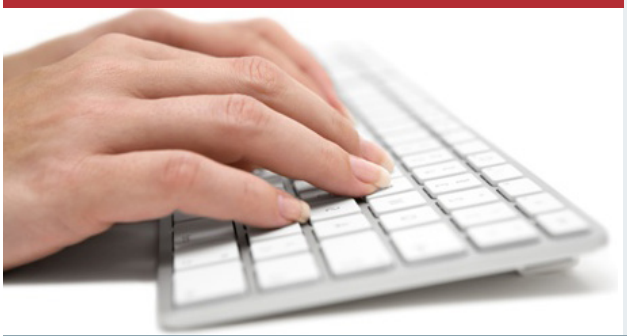

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Society of Financial Examiners®
3505 Vernon Woods Drive
Summerfield, NC 27358
Tel 336-365-4640
Fax 336-644-6205
www.sofe.org