

Managing Specialists on Risk-Focused Examinations

By William Michael and Alex Quasnitschka

Have you ever been involved in a risk-focused examination (“RFE”) where the results of the Information Technology (“IT”) Review were provided AFTER fieldwork had been finalized?

How about this one – have you ever been involved in an examination where the actuarial analysis was being performed only a few weeks before the 18-month deadline of June 30th?

As a specialist, have you even been involved in a financial examination where the Examiner-In-Charge (“EIC”) did not communicate or share details on the expected timeline and key deadlines?

Hopefully the answer to these questions is “no,” but it is certainly possible you have faced a situation like one of the above in the past. Most of us have likely experienced situations where coordination with our specialists was not as effective as it could have been in hindsight, thereby resulting in some concerns or even heightened levels of stress during a RFE. Sound familiar?

While there is no doubt that everyone involved in conducting exams is busy-whether it is individuals from state insurance departments, vendors, or contractors-we will probably all acknowledge that we have many important priorities on our plates at any given moment, so we might ask why we need to devote valuable attention and time to monitoring others’ work. But ineffective coordination with specialists can be a “self-inflicted wound” that should be avoided. The time you spend investing up front to avoid these issues will pay dividends in the long run!

Effective coordination with specialists is a critical factor impacting the quality of financial examinations. Operating as a cohesive unit also reduces execution risk and helps to ensure that all critical solvency concerns are identified. Working collaboratively is not solely about meeting deadlines and getting work completed timely-it is about performing an effective examination that identifies any current or

prospective solvency concerns. As a result, examination teams should be focused on ensuring that the coordination with specialists is effective and present throughout the course of the examination. The specialists involved on RFEs are focused on some of the most critical risks that could cause solvency concerns for insurance companies (e.g., cybersecurity, reserving, pricing, etc.).

Use of Specialists

First, a decision must be made regarding what types of specialists, if any, are required for a financial examination. This is an important decision made by the insurance departments, and there are a number of factors that need to be considered, including the following:

- **Complexity of the Company** – Does the company have a significant amount of complex systems? Has the Company experienced any cybersecurity breaches? Is the investment portfolio complex with a fair amount of “risky” holdings? Are there complicated reinsurance contracts that are difficult to understand? These are all considerations when determining the expertise required for a RFE and if any specialists are necessary.
- **State Concerns** – The overall level of concern on behalf of the state is an important factor as well. For example, if the analysts have ongoing concerns regarding the amount of internal reinsurance contracts and they feel that they do not have a complete understanding of how the Company is managing its reinsurance program, a Reinsurance Specialist may be required as part of the RFE process.

The majority of examinations require Actuarial Specialists and IT Specialists, although there are a number of exceptions. Additionally, some RFEs may require the help of Investment Specialists, Reinsurance Specialists, Statutory Accounting Specialists, and others. It is also important to note that there may be a need for Cybersecurity Specialists as well. Cybersecurity is a high risk area, and if there are specific factors or concerns deeper expertise could be needed for a

cybersecurity review. We also should consider the risk of companies developing Cyber products and covering their customers' cybersecurity risks. Similar to all other lines of business, it is critical that insurance companies understand the nature of the risks they are accepting and perform strong underwriting; if such products are written by an insurer, these risk areas could be reviewed and assessed by a Cyber Specialist from an examination perspective.

Effective Coordination with Specialists

Managing specialists effectively boils down to the EIC taking the initiative to communicate on a regular basis with each of the specialists involved on a RFE. Sounds like a simple concept, right? But we all know that communicating effectively takes effort-from all parties. It can be challenging because we know how easily the weeks start to turn into months, so best practice would suggest this area should be a primary point of focus for the EIC. We cannot assume that the specialists are on the same timeline as the EIC without the presence of solid communication. EICs need to take a vested interest in the work being performed. Two other important elements that occur on some RFEs that further highlight the importance of effective communication are:

1. Many specialists tend to work offsite. As a result, the EIC may not have those discussions that occur naturally during the course of a day from sitting next to each other and working side by side. As such, it requires more effort to dialogue regularly so everyone is on the same page.
2. Many specialists are frequently working on various engagements concurrently. Their work tends to be a bit more part-time in nature, so they often juggle roles on multiple exams and projects. This creates a situation where specialists may have competing priorities and deadlines. Therefore, it becomes critical to get out in front to this to ensure there is no slippage in work performed or completion of deliverables.

The following is a suggested checklist of items the EIC and specialists should agree to in advance of fieldwork to ensure effective coordination throughout the examination. Each of these areas essentially relates to communicating effectively and ensuring regular dialogue takes place regarding all critical matters on the examination. Some best practices to ensure this occurs are as follows:

1. **Check-ins** – Schedule weekly check-ins with each specialist involved on the exam, even if you are working onsite together. These discussions may only last a few minutes, but it will ensure progress continues to be made and can help avoid slippage of key tasks or follow-ups. Maintain frequent communication with the specialists throughout the exam is critical, even on smaller company exams that may have tighter budgets.
2. **Planning** – The EIC should be involved early in the planning process for specialty areas. Consider risks that affect financial processes and prospective risks. Specialists should inquire up front about specific expectations.
3. **Budgets** – Actively manage the budget and perform budget to actual analyses throughout the exam. Provide this information to the specialists so they are clear on the amount of time remaining in the budget as compared to the progress of the work.
4. **Involvement in Meetings** – Ensure the specialists are involved in the kick-off meeting and certain C-level interviews, where it makes sense.
5. **Company Status Meetings** – Determine the appropriate level of involvement in the company status meetings. It is typically helpful to have the specialists provide updates on their respective areas.
6. **Status Reports** – Obtain content for specialty areas for inclusion in status reports. Provide any specific status report formats up front. Consider creating a reminder in Outlook a few days in advance of when status reports are due to ensure all content is provided to the EIC timely.
7. **Scope** – Ensure the scope of the specialists' work is clearly understood by all parties, including expected timing for completion of work and deliverables.
8. **TeamMate** – Clarify expectations for TeamMate documentation.
9. **Deliverables** – Ensure specific deliverables for each phase are agreed upon (e.g., planning memos, matrices, reports, etc.)
10. **Reports** – Obtain input for key reports and memos (e.g., exam reports, management letter, Summary Review Memorandum (“SRM”), etc.)
11. **Exam Protocols** – Communicate exam protocols (e.g., examination requests to the company, reporting of findings, etc.)

Common Specialists Involvement

The two areas for which we most frequently utilize specialists are IT and Actuarial. In addition to the tips for effective coordination noted above, it is important that the EIC effectively communicate the expectations for the procedures to be performed and the key deliverables in the beginning of the engagement. The following is a summary of common deliverables and the timing of the procedures for these two specialist areas.

Information Technology

The most important aspects of the IT Review and the key deliverables and expected timing are as follows:

- **Timing** – As noted in the Financial Condition Examiners' Handbook ("Handbook"), "In a risk-focused examination, steps 1–5 of the general IT review process should be performed prior to the completion of planning the overall financial condition examination." This timing is significant because an effective IT general control environment provides examiners with increased assurance regarding the overall reliability of a company's IT systems and the reports generated from those systems and should factor into the financial examiners' overall planning.
- **Conclusion** – The IT Specialist's conclusion regarding effective or ineffective IT general controls ("ITGCs") is critical and impacts the work performed by the examination team in Phase 3. For example, if the ITGCs are deemed to be "effective," the financial examination team has the ability to test and rely on automated application controls.
- **Deliverables** – The primary deliverables from the IT Review are as follows:
 - **IT Planning Memo** – The Handbook notes that "after the work program has been finalized, the IT examiner should document the plan to complete the IT review." The IT Planning Memo should be completed at the end of Step 3 and approval from the EIC and supervisors should be obtained before Step 4 is started. It is important the IT Specialist provide details regarding the leverage of third party work and the controls that will be testing independently in Step 4.
 - **IT Summary Memo** – Captures conclusions regarding IT related controls' effectiveness (or ineffectiveness) and findings/recommendations. If the ITGCs are deemed to be "ineffective," the memo should specify what areas are not reliable and the impact of each. The results of the IT Review should be formally discussed with the EIC. In addition, the EIC and all states involved in the examination should

review and sign-off on the memo in TeamMate as evidence that the work of the IT Specialists and their final conclusions have been accepted.

- **Cybersecurity Memo** (if applicable) – If procedures in addition to those already included as part of Exhibit C are being performed to assess the company's cybersecurity controls (e.g., regulations such as those following the NAIC's Data Security Model Law), a separate memo may be useful to provide details of the work performed, reliance on the work of others, key observations and conclusions, and any required recommendations.

As noted previously, it is vital that the EIC communicate the overall timing of the examination so the IT Specialists are aware of when Phase 3 work is expected to begin. The expected wrap-up date for Phase 2 serves as the deadline for the IT Review to be completed, according to the NAIC's Accreditation guidelines, including issuance of the final IT Summary Memo.

These are the most critical aspects of the IT Review; however, there are several other important items to consider to ensure the IT and Financial Examiners integrate efforts and work together effectively. The following is a listing of best practices the EIC is encouraged to follow:

- Involve IT examiners in key meetings, even if those meetings seem more financial oriented.
- Ask IT examiners to attend key process walk-throughs along with financial examiners to understand business processes and functions that are important to financial examiners.
- Consider inviting IT specialists to key C-level interviews (e.g., Chief Operating Officer ("COO") if IT reports into the COO; Chief Risk Officer ("CRO"); Internal Audit, etc.) in addition to those that are IT specific in nature.
- Consider the IT examiner's involvement when reviewing significant identified risks and controls within Key Functional Activities ("KFAs"). This should be done early in the planning stages, to the extent possible.
- Involve the IT examiners to help determine whether some risks in KFAs may be best mitigated by automated, system-based controls (vs. manual, people-based ones).
- Pull in IT examiners to achieve common agreement on significant applications supporting KFAs to be scoped in. Prioritize the applications together to use budgeted hours effectively.
- Maintain regular dialogue throughout the course of work to ensure everyone is on the same page.

- Discuss preliminary IT results as the examination work is executed. This will help ensure a “no surprises” environment, meet NAIC Accreditation requirements, and complete IT work before the conclusion of Phase 2.
- Ensure there is clear documentation following the Handbook’s 6-step process for IT reviews.
- Ensure the work documented in the TeamMate project is easy to follow and is aligned specifically to procedures.
- Coordinate with the IT Specialists to ensure the work of third parties is being utilized and relied upon where appropriate. It is important to look for efficiencies and streamlining of documentation to minimize/avoid duplication of effort.
- Keep the NAIC’s guidance in mind regarding volume of supporting workpapers. Specifically, if placing full reliance, the IT examiners do not need to catalog (and should not load into TeamMate) every single CPA or Internal Audit workpaper where testing is to be relied upon.
- For large insurance groups and coordinated exams, ensure all legal entities are scoped in, as appropriate, and listed in the IT Planning Memo. A reviewer of the IT Planning and Summary Memos should clearly understand the IT environment and the entities that are included in the scope and covered by the work of the IT Specialists.

Following these best practices and the recommendations noted above in the “Effective Coordination with Specialists” section will help to ensure the IT Review is completed timely in an effective and efficient manner.

Actuarial

Traditionally, when we think of Actuarial specialists we generally assume they will be focused on reserves; however, actuaries can provide assistance in a number of other critical areas. The expertise that actuaries provide is a valuable asset when considering a company’s most significant risks. As a result, we should involve the Actuarial specialists in more than just reserving activities. The knowledge and expertise provided by actuaries significantly adds to the effectiveness of the examination. Some additional areas where actuaries can add value include the following:

- Pricing and Underwriting
- New Product Development
- Reinsurance risks, including risk transfer
- Liquidity analysis and forecasting
- Model risks
- CAT risk
- ORSA review, especially for the more complex areas

We also tend to assume that the large majority of the Examination Actuaries’ work will be performed as part of

Phase 5. Prior to the RFE process, the actuary was generally only involved at a kickoff meeting and then spent most time providing loss reserve estimations. This is another key aspect of the actuaries’ role that has evolved over the years on RFEs. Actuaries are encouraged to be involved in all aspects of a RFE, from the beginning (i.e., pre-planning/budgeting) through the conclusion of work and conducting a wrap-up meeting with the financial analysts. As such, the timing of work and the key deliverables can be summarized based on each of the seven phases of a RFE:

- **Phases 1-2** : Examination Actuaries should be focused on gaining an understanding of the Reserving, Pricing & Underwriting processes, and identifying and assessing the related risks. They should also identify potential strategic initiatives requiring actuarial review (e.g., new product development). The actuaries should review key documentation and participate in some of the C-level interviews; for example, the Chief Actuary, Chief Underwriter and Chief Claims Officer. Other meetings and/or walk-throughs should be completed as deemed necessary, such as meetings with pricing actuaries and review of models utilized by the insurer. A key deliverable for Phases 1-2 is completing the relevant portions of the Examination Planning Memo and/or a separate Actuarial Planning Memo detailing an overview of the pricing and reserving processes, along with the significant risks and assessments to be included on the risk matrices. The EIC and actuaries should come to a consensus on the risks to be included on the risk and control matrices (“matrices”). The risks included on the Pricing and Reserving matrices serve as the basis for testing performed in the later phases.
- **Phases 3-4** : Examination Actuaries should be involved in the identification of controls, overall plan for testing of controls, performing the testing of controls, the control assessments and the residual risk assessments. These conclusions influence the level of substantive work to be performed. A detailed work plan for Phase 5 should be developed with procedures that tie to individual risks.
- **Phase 5**: The majority of Examination Actuaries’ test work is performed during Phase 5. The actuaries will perform the testing and evaluation of reserves, and a recalculation of reserves, if deemed necessary. At the conclusion of testing, an Actuarial Report should be drafted. It is important that the EIC discuss expectations for the template/format of the report. It should include sufficient detail to support findings, and all issues, conclusions and recommendations should be clearly defined.
- **Phases 6-7**: The Examination Actuaries should provide input into the SRM and provide recommendations for ongoing monitoring if necessary. In addition, the actuaries

should draft any actuarial information included in the exam reports. All issues and recommendations should be clearly defined and included in the Management Letter or Exam Report.

Summary

EICs need to proactively manage the specialists to better ensure the full team is working cohesively as one unit. This proactive management approach is vital to the success of any financial examination and significantly reduces execution risk. When financial examiners and specialists are coordinated appropriately, the examination is executed more effectively. An effective examination helps ensure that all significant risks are identified and that the appropriate amount of testing is performed. In essence, there will be less of a chance of any important items “slipping through the cracks”, and the risks of missing deadlines or exceeding the budget are greatly reduced.

Effective coordination with the specialists also helps ensure that valued added recommendations are communicated to the financial analysts for follow-up and ongoing monitoring, which adds to the effectiveness of the risk-focused surveillance cycle. Although it might seem like a challenge at times to keep a finger on the pulse for each of the aspects noted throughout this article, the time invested to do so will yield rewards. Take the extra time upfront in laying out exam expectations with the specialists. Throughout the exam, schedule recurring meetings to ensure the exam is progressing and the EIC and specialists are on the same page. Following these action steps should lead to a smoother exam...because we're all busy, and nobody likes negative surprises!

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