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COMPLIANCE & ETHICS FORUM FOR LIFE INSURERS

The State Regulatory Examination Process and its Impact Upon Compliance

CEFLI Compliance Fundamentals Training Conference

Moderator: Kathy Donovan – Wolters Kluwer Financial Services

Panelists: Cliff Day (NJ Dept. of Banking and Insurance)

Yonise Roberts Paige (PA Insurance Department)

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Market Regulation of Life Insurers

Regulators utilize:

- Examinations
- Surveys
- Reporting requirements and/or data calls
- Analysis of available company/industry data

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Market Regulation Exam Types

- Comprehensive exams
- Targeted exams
- Limited-scope exams

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Operational Areas of Examination

- Operations/management
- Complaint handling
- Marketing and sales
- Advertising materials
- Claims handling
- Licensing
- Policyholder service
- Underwriting and rating
- Rate and form filings

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Market Regulation

- Market analysis
- Market conduct exams
- Interstate collaboration

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New Jersey Department of Banking and Insurance

Overview of the Market Conduct Examination Process

June11, 2014

Clifton Day, MPA, CPM, CSM
Chief of Market Regulation and Consumer Protection Services
NJ Department of Banking and Insurance

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What is a Market Conduct Examination?

- A review of an insurer's conduct and regulatory compliance in the marketplace.
  - Types of Examination
    - Comprehensive (claims, underwriting, rating, complaints, policyholder service, terminations, etc.) Conducted at company site.
    - Targeted (life and annuity replacements, annuity suitability). Focus is policyholder service). Conducted at company site.
    - Desk (may be comprehensive or targeted analysis of electronic records, paper documents, etc.). Conducted off site, usually at regulator's office.
    - No-Knock (targeted, without advance notice)
    - Multi-State (can be comprehensive or targeted). Conducted at specified regulator offices and at company site. NAIC coordinated. But states do informally collaborate.
    - Re-Examinations (most likely targeted, with focus on concerns from prior exams).

What is reviewed in a Market Conduct Examination?

- Scope may include any one or more of the following company activities:
  - Complaints (valid or not valid, cause, correction).
  - Claims (paid, denied, compromised, cob, subrogation).
  - Policyholder Service (contract issuance and renewal, loans, withdrawals).
  - Terminations (rescissions, cancellations, nonrenewals).
  - Underwriting (risk assessment, tier eligibility.)
  - Rating (tier placement, base rates and increase/decrease factors).
  - Sales, Advertising and Marketing (fair, misleading, unfair competition).
  - Management, Operations and Control (oversight of regulatory and business practices, leadership continuity).
  - Agency/Producer Licensing and Appointments (propriety of license for business written and serviced).

How is a company selected for examination?

- NAIC Standards Regarding the Selection Process
  - Baseline Review
    - Comprehensive analysis of state and national market and financial data reported in *Market Conduct Annual Statement*. Over 250 data elements (complaint index, premium changes, replacement to new business ratios, etc.) for every company in each state.
      - Credit
      - Group and Individual Accident and Health
      - Group and Individual Annuity
      - Group and Individual Life
      - Long Term Care
      - Medical Supplement
      - Private Passenger Auto
      - Homeowners
  - Identify Outliers and Trends (simplified example below)
    - Top 10 or 20 with greatest state market share with a confirmed complaint ratio greater than 2.5 times the state average.
    - Of those 10 or 20, which 10 have a surrender to new business ratio that exceeds 3:1.
    - Which companies trend upward and downward for the past three years
    - If upward, may proceed to Market Analysis Level 1.

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How is a company selected for examination (continued)?

- NAIC Standards regarding the Selection Process (continued)
  - Level 1 Analysis (Standardized Review of Specific Variables).
    - Management changes.
    - Mergers, consolidations.
    - Risk-Based Capital Ratios and Financial Analysis Solvency Tool Ratios.
    - NAIC SAD (Special Activities Database) Activity.
    - Substantive regulatory actions nationally.
    - National frequency of MCE's in the last 12 and 60 months. Concerns?
    - Other State Initiatives.
    - Significant premium increases or decreases over time.
    - Market share trends over 5 years..
    - Loss and Expense Ratios.
    - Resisted claims compared to total claims.
    - Confirmed complaint index trends.
    - Replacement and surrender ratios.
  - If positive or neutral findings, process may end. If concerns are noted, may proceed to Market Analysis Level 2

How is a company selected for examination (continued)?

- NAIC Standards regarding the Selection Process (continued)
  - Level 2 Analysis (Broad Review of Overall Environmental Variables).
    - Goal
      - Confirm or rule out regulatory issue identified by Level 1 analysis
      - Determine root cause and overall impact of issue
    - Analysis includes (but not limited to)
      - Consumer Complaints
      - Company response to prior regulatory activity
      - Current and prior market regulation examination (issue may have been resolved)
      - Interdepartmental and intradepartmental communication
      - Financial analysis
      - Internet/World Wide Web
      - Geographical or regional issues
      - Other Gov't and Quasi-Gov't Agencies
  - If positive or neutral findings, process may end. If concerns are noted, may proceed to the *Continuum* of potential responses.

How is a company selected for examination (continued)?

- NAIC Standards regarding the *Continuum Process*
  - Potential Regulator Responses
    - Goal
      - Develop an individually tailored response to the issue.
      - Implement least invasive response that addresses concerns.
      - Mitigate consumer harm.
    - Methodology
      - Review existing NAIC resources (RIRS, ETC, MITS, SAD).
      - Collaboration among jurisdictions.
      - Determine scale of concern (multi-jurisdictional?).
      - Determine goal (discontinue practices, remediate, reinstate, etc.).
    - Response Options
      - Informal (telephone call, email, interviews, interrogatories, informal agreement, voluntary compliance).
      - Formal (market regulation exam, with or without administrative penalties, Cease and Desist Orders, Consent Orders, license revocation, restitution/remediation).
    - Closure
      - No further action, referral to other agencies, monitoring, education, compliance.

Steps in the Market Conduct Examination

- Notice to Examinee
  - Formal letter to company president stating authority, scope of review, documentation and data needed to prepare for the exam. Sixty-days advance notice unless no-knock.
- Pre-Exam Preparation
  - A Pre-examination conference is held with the company's exam coordinator and key personnel to clarify data call and describe the examination process.
  - Random selections from population data are extracted and provided to examinee in advance, or throughout exam.
- Field Phase of Examination
  - On-site fieldwork begins. Examiners review paper and electronic records. All potential errors generate a written inquiry of findings to encourage a company response. Assures validity of exam findings; provides the company an opportunity to explain and document its position. A 3-working day turnaround is requested, but extensions are common.
  - An "exit conference" is held at conclusion of the on-site examination. During this meeting the examiners discuss major findings and the remaining steps to complete the examination.

Steps in the Market Conduct Examination (Continued)

- Post-Field Activity
  - Analysis of information examined, review of files or other information taken off-site and a review of any outstanding data requests.
  - Under the direction of the examiner-in-charge, the exam team finalizes the draft examination report. This is reviewed internally by management staff.
  - The draft examination report is issued to company for review and comment. Companies are provided 30 days to respond.
  - The company response is reviewed and any changes appropriately supported in the company response are made to the draft. The Chief of Market Regulation prepares a recommendation to the Assistant Commissioner to adopt the report. The Director and Commissioner review and approve the adoption recommendation and the Adopted Report is issued to the Company, in standardized format.
- Post-Report/Compliance Phase
  - Errors are addressed by recommendations to remediate and prevent recurring errors. The company is generally provided 30 days to implement these recommendations and report back to the Department.
  - Enforcement issues arising from the examination findings are thereafter considered and pursued with the company, as appropriate.

Market Conduct Examination (a few afterthoughts)

- Informal considerations:
  - An exam doesn't have to be adversarial.
  - Positive and effective communication during the pre-exam conference and field work will accelerate completion.
- Common Impediments to Timely Completion
  - Omitted fields and incorrect format in data calls
    - Dates missing or in text versus date format (we ask for corrected datasets)
    - Duplicate records that result in larger random samples (and more time at the audit location)
  - Incomplete or inaccurate responses to inquiries.
    - We read every response to assure our understanding of the company's position. Accuracy assures mutual understanding. Not uncommon for 1 or more follow ups. Goal is to be accurate when the draft report is issued to a company, with no surprises.
    - Don't hesitate to ask for more time to research an inquiry. We ask for 3 working days, but we understand that complexity may warrant additional time.
  - Assumption that the exam team really doesn't need access to all requested systems.
    - Yes, we really do need access all those systems. The exam is designed around the information contained in those systems. If access is not provided, production delays ensue.

Pennsylvania Insurance Department

Overview of the Market Conduct Examination Process for Life and Health Insurance

June11, 2014

Yonise Roberts Paige, MCM
Chief, Life and Health Division
Bureau of Market Actions
Pennsylvania Insurance Department

The History of Market Conduct Examinations

- Began in 1969 as a new form of examination, first in Illinois, followed in 1972 by Missouri and New Hampshire.
- The McKinsey report, funded in 1973 by the NAIC, pointed out that financial examinations were too lengthy and too infrequent to prevent insolvencies.
- The NAIC A6 Subcommittee adopted this concept in 1974 with the hope that the new examination would help to either impede and/or prevent company failures.

What Are the Different Types of Market Conduct Examination and the Scope?

- Comprehensive Exam
  - Marketing, Sales and Advertising
  - Forms {policy, certificates, riders, amendments, applications, etc.}
  - Producer Licensing {appointment, termination and commissions}
  - Consumer Complaints
  - Underwriting {guidelines, issued, replacements. surrenders, terminations, policy loans, etc.}
  - Company Operations and Management {Internal Audits and Compliance Procedures, Vendor and TPA Agreements, MCAS validation}
  - Claims Manual and Claims {Paid, Denied and Pended}

What Are the Different Types of Market Conduct Examination and the Scope?

- Target Exam– Usually a More Focused Review
  - Viatical Settlements
  - MCAS Validation
  - Replacements
  - Surrenders
  - Policy Loans
  - Claims
  - Re-Exam

What Are the Different Types of Market Conduct Examination and the Scope?

- Desk Exam – typically a market conduct examination with a specific purpose
  - Continuum Projects - Survey {e.g. Autism, Long Term Care, Drug & Alcohol, Mental Health, etc.}
  - Oversight Reviews - Self-Reporting by a Company of Market Conduct Issues
  - Self-Audits
- Multistate-Exam - a comprehensive or target market conduct examination focused on issues that effect multiple jurisdictions.
  - Coordinated in conjunction with the NAIC
  - Involves Lead States and a Managing Lead State.
  - All other states sign-on as participants

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How is a company selected for examination?

- The PID Follows the NAIC Standards Regarding the Selection Process
  - Baseline Review of All the Insurance Companies in the Industry. Based on MCAS and Financial Annual Statements.
  - Identify Outliers and Trends from Baseline
    - Companies trend upward and downward for the past three years
    - Trends of concern may result in a Market Analysis Level 1.
- Market Analysis Level 1 – An automated process conducted through the NAIC I-SITE. After further analysis, companies are identified that need Market Analysis Level 2.

How is a company selected for examination?

- Market Analysis Level 2 - Review of specific documents and information such as Class Action Lawsuits, Consumer Complaint files of the Company and the Pennsylvania Insurance Department.
- Results from Level 1 and Level 2 are presented in a Report to the Deputy Commissioner for potential action (Types of Exams).

The Market Conduct Examination Process

- Notification - Announcement letter to the Company President
  - Authority
  - Type of Exam
  - Scope of review
  - Identifies if a Contractor Examination Team will be involved as applicable
  - The company has 10 business days to respond to identify the coordinator.
  - Typically 60 days prior to the commencement of an examination
  - The examination is opened on the NAIC ETS.
- Preliminary Examination Packet
  - NAIC Standardized Data Request (SDR) are used to request data for the exam by type of insurance and line of coverage.
  - A Pre-examination conference call is held with the company's exam coordinator and key personnel {IT Personnel and Business Unit Managers} to discuss the data call and describe the examination process.

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The Market Conduct Examination Process

- Universe Data Acceptance, Analysis and Sampling
  - The in-house examiner-in-charge analyzes and reconciles data with the company's financial statement and market conduct annual statement filings. Clarification is sought for discrepancies.
  - Random Sampling is performed.
- File Request Letter
  - Identifies the consumer files subject to review.
  - Identifies the records that are necessary as part of the review process. Unless otherwise stated, the entire file is required for review.

The Market Conduct Examination Process

- Examination Phase 1 – at the Regulator's Office
  - Exam Administration – preparation of exam test papers and summaries
  - Marketing, Sales and Advertising Testing
  - Producer Licensing Testing
  - Forms Testing
  - Internal Audits and Compliance Testing
  - Vendor and TPA Agreement Review
  - Underwriting Manual(s) Review
  - Claims Manual(s) Review

The Market Conduct Examination Process

- Examination Phase 2 – at the Company's Office
  - Examiner-in-charge conducts an on-site kick-off meeting
  - Examiner conducts interviews with Key Company Personnel
  - Examiners review records (paper and electronic).
  - Examination results are communicated in an **Initial Summary**. The Company has 5 business days to respond unless the company files and receives a written extension.
  - The **Initial Summary Company Response** is reviewed along with additional documentation provided to remove violations.
  - The **Exit Summary** is provided to the Company in preparation for the **Exit Conference**.
  - The **Exit Conference** is held at conclusion of the on-site examination in preparation of the draft **Report**. During this meeting the examiners discuss examination findings and the process to complete the examination.

The Market Conduct Examination Process

- Examination Phase 3 – at the Regulator's Office
  - The Examiner-in-charge finalizes the draft examination Report. Companies are encouraged to provide ALL evidence to remove violations prior to the issuance of a report to avoid tolling time issues.
  - The draft examination Report is reviewed by the Chief and Director prior to issuance to the Company.
  - The draft examination Report is issued to the company for review and response in both electronic and in paper format. The Company has 30 days in accordance with Statute to respond.
  - The company response is forwarded to the PID in both electronic and in paper format. The PID has 30 days to resolve the examination and finalize the Report after receiving the Company's response. The Chief prepares a recommendation for the Commissioner's Designee (Deputy Commissioner) for consideration of the Report. A meeting is held with the Director and Deputy Commissioner to review the results and to receive instructions on how the Company may dispose of the examination (Consent or Closure Order).

The Market Conduct Examination Process

- Examination Phase 3 – at the Regulator's Office
  - The Chief contacts the Company to advise of the Consent or Closure Order details including any penalty that may be applicable.
  - The Consent Order must be signed by 2 Company Officers
  - The Public Report is Finalized and includes the Consent or Closure Order.
  - The Company forwards the penalty money, completes and forwards to the PID a Director's Affidavit to confirm the Officers and Board of Directors of the Company have received a copy of the Report.
  - The examination is closed on NAIC ETS.

Market Conduct Examination Impediments

- Data sets do not comply with data requested
  - Data is not segregated by type of insurance or line of coverage
  - Data sets don't match filed Financial and MCAS Statements
- The Coordinator is an inactive participant in the examination.
  - Validation is not performed by the Company Coordinator prior to forwarding the requested universe data to the PID. Especially when there are TPAs involved and their IT personnel mine data.
  - No review or reconciliation is performed by the Company Coordinator prior to forwarding the requested file documentation to the PID.
- The Coordinator is a gatekeeper.
  - The coordinator decides that the requested file documentation is unnecessary to provide as part of the examination.
  - The coordinator assumes that the exam team really doesn't need access to all systems.

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Market Conduct Examination Impediments

- An assumption that the examination team can learn the Company's IT system in a few hours training session to successfully navigate the review of records.
- Insufficient Company resources dedicated to assist with the examination.
- Adversarial Posture
- Inattentiveness during pre-examination and on-site kick-off conference meetings which requires examination team to cover on multiple occasions topics already discussed.

Market Conduct Examination Impediments

- Providing the exact same/duplicate documentation after receiving the Initial Summary in an attempt to remove violations.
- An assumption that records retained by Company vendors and TPAs are not the responsibility of the company.
- Contacting PID Senior Management with incomplete examination results and inaccurate information.

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Compliance & Ethics Forum for Life Insurers
P.O. Box 30940
Bethesda, MD 20824

www.cefli.org